89-107

NO. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

URQUHART & HASSELL,
Petitioner

v.

CHAPMAN & COLE, C.C.P., LTD. AND
NORMAN EHRENTRAUT,
Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

W. JAMES KRONZER
1001 Texas Avenue
Suite 1030
Houston, Texas 77002
(713) 236-1722

Counsel of Record for Urquhart & Hassell

Alpha Law Brief Co., Inc. — 8748 Westpark — Houston, Texas 77063 — 789-2000

QUESTIONS PRESENTED

1. Is a signatory attorney's "knowledge, information and belief" under Rule 11, Fed. R. Civ. P., to be measured by an analysis of what the attorney did, or could, believe after reasonable investigation or by a hindsight objective test of the ultimate merits of the claim filed?

2. Is the legal conclusion that specific conduct violates Rule 11, Fed. R. Civ. P., properly reviewed *de novo* by an appellate court as an issue of law, as held by the Ninth, D.C., Second, Eighth and Eleventh Circuits, or by a plain abuse of discretion standard of review as held by the First, Third, Fourth, Fifth, Sixth and Tenth Circuits?

3. Was the Fifth Circuit's review of the imposition of sanctions under Rules 11, 26 and 37, Fed. R. Civ. P., so fundamentally inadequate and unfair that petitioner was effectively denied the due process right of an adequate appellate review?

LIST OF PARTIES

The parties to the proceedings below included the petitioner Urquhart & Hassell and the respondents Chapman & Cole, C.C.P., Ltd., and Norman Ehrentraut. Itel Containers International B.V. and Itel Container International Corporation were also parties in the court below and were non-adverse to petitioner.

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Petitioner Urquhart & Hassell respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above proceeding on February 17, 1989.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 865 F.2d 676, and is reprinted in the appendix hereto, p. 1a, *infra*.

The memorandum and order of the United States District Court for the Southern District of Texas is reported at 116 F.R.D. 550, and is reprinted in the appendix hereto, p. 31a, *infra*.

JURISDICTION

On July 22, 1987, the district court imposed Fed. R. Civ. P. 11 (hereafter Rule 11) sanctions against petitioner Urquhart & Hassell. (See page 37a, *infra.*) On petitioner's appeal the Court of Appeals for the Fifth Circuit affirmed the order of the district court on February 17, 1989. (See page 1a, *infra.*) Petitioner's Petition for Rehearing and Suggestion for Rehearing En Banc were denied on April 17, 1989.

The jurisdiction of this Court to review the judgment of the Fifth Circuit Court of Appeals is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS AND RULES OF PROCEDURE INVOLVED

STATEMENT OF THE CASE

A. Introduction

Petitioner Urquhart & Hassell is a law firm located in Houston, Texas and represented Itel Container International Corporation and its successor in interest, Itel Containers International B.V., in the district court. (Itel Containers International B.V. and Itel Container International Corporation are hereafter jointly referred to as "Itel".) Edward

D. Urquhart was admitted to practice law in Texas on November 1, 1976. Silvia T. Hassell was admitted to practice law in Texas on May 12, 1982. Prior to the instant case neither petitioner law firm nor attorneys Urquhart and Hassell had been the subject or any sanctions orders by any court.

On November 22, 1982, Chapman & Cole, as lessor, sued Itel for breach of an Industrial Lease Agreement, which called for Chapman & Cole to "build to suit" a container storage facility to be leased by Itel. C.C.P., Ltd. was brought in by Chapman & Cole as a real party in interest. (Chapman & Cole and C.C.P., Ltd. are hereinafter jointly referred to as Chapman & Cole.) Itel, as leessee, counterclaimed against Chapman & Cole for breach of the Lease Agreement, breach of warranty, fraud, fraudulent concealment, negligence and violation of the Texas Deceptive Trade Practices - Consumer Protection Act, basically alleging that the facility fell apart because it was constructed improperly, that Chapman & Cole was aware of the improper and imprudent construction prior to advising Itel to move on to the facility, and concealed this fact from Itel.

On October 19, 1984, following approximately two years of initial inquiry and discovery into the causes for failure of the storage facility leased by Itel, Urquhart & Hassell commenced a third-party action on behalf of Itel against Norman Ehrentraut ("Ehrentraut"), an ex-employee and general partner of Chapman & Cole, under 18 U.S.C. §§1961 *et seq.*, the Racketeer Influenced and Corrupt Organizations Act ("RICO") alleging violation of the Texas Commercial Bribery Statute as the predicate acts under RICO. Ehrentraut cross-claimed against Chapman & Cole for indemnity or contribution from Chapman & Cole in the event Itel recovered against him based on Ehrentraut's relationship as an employee/general partner

of Chapman & Cole. Chapman & Cole cross-claimed against Ehrentraut for indemnity or contribution in the event Itel should recover against Chapman & Cole.

B. Petitioner's Pre-Filing Inquiry Into the Facts Underlying the RICO Claim

Petitioner's inquiry into the facts made the basis of the RICO claim against Ehrentraut was initiated as a result of attempting to determine the cause for failure of the facility. Petitioner first consulted with Itel's expert who advised petitioner that the construction methods used were grossly improper. Petitioner then deposed the construction superintendent (McGraw) and an owner of the facility (Howard Chapman). Chapman & Cole denied they were to blame for the facility's failure. Notwithstanding these protestations, the files of Chapman & Cole clearly evidenced improper construction methods on the part of Novotny of Dantex Erectors ("Novotny"), the concrete subcontractor. The records showed all his work had to be redone. Howard Chapman testified at his deposition that Ehrentraut, who had been assigned to supervise Novotny's work, left his employment during the Itel construction as a result of a "mutual decision" because he had other business interests. However, petitioner then talked with the architect for the project (Montgomery) who indicated he had heard from a Chapman & Cole employee that Ehrentraut took kickbacks from a subcontractor on the Itel facility, and that Howard Chapman discovered this immediately before Ehrentraut was fired. Petitioner then formally deposed Montgomery, and he admitted under oath and on the record to the statements he had previously made regarding Ehrentraut. Petitioner then deposed Ehrentraut and he admitted that during the time he was responsible for supervising Novotny he secretly took payments from him, and was secretly a partner with

him. Ehrentraut also produced a copy of the subcontract he awarded to Novotny for the Itel job while he was simultaneously a covert partner with Novotny and an employee of Chapman & Cole. Ehrentraut testified, contrary to Howard Chapman's prior testimony, he was fired by Chapman & Cole in December of 1980 for not supervising the jobs to which he was assigned. Further, Ehrentraut admitted that about the time he was fired *Howard Chapman accused him of taking kickbacks from Novotny* and told him kickbacks were illegal. Petitioner then interviewed Novotny and he admitted that in late 1980 he went to Howard Chapman and disclosed the secret payments he had made to Ehrentraut. Petitioner obtained from him copies of cancelled checks evidencing the payments which totalled $13,650.00. The first payment was made on June 20, 1980, the date the lease between Chapman & Cole and Itel was signed, and the last payment was made on December 17, 1980, at or about the time Ehrentraut was fired by Chapman & Cole.

These events were concealed from Itel however, and shortly thereafter Itel was given the go ahead to move on to the facility. Thereafter the facility construction fell apart, Itel moved off, Chapman & Cole sued Itel for breach of the lease, and Itel counterclaimed against Chapman & Cole.

C. Petitioner's Application of Existing Law to the Facts Discovered During Its Pre-Filing Inquiry

Petitioner then determined that Itel had a cause of action as a result of Ehrentraut's activities. Urquhart & Hassell made an analysis of the prima facie elements of a RICO action under §§ 1962(c) and 1964(c) in light of the evidence and facts known to petitioner as described above. Under RICO § 1962(c) it is unlawful for a person employed by an enterprise engaged in, or

the activities of which affect, interstate commerce, to conduct or participate, directly or indirectly, in such enterprise's affairs through a pattern of racketeering activity. Any person injured in his business or property by reason of a violation of 18 U.S.C. § 1962 may bring an action in United States District Court to recover treble damages sustained plus the cost of the suit, including reasonable attorney's fees. 18 U.S.C. §§ 1964(c), 1965, and 1961(3). "Racketeering activity" is defined under § 1961(1)(A) to include "any act . . . involving . . . bribery . . . which is chargeable under state law and punishable by imprisonment for more than one year." "Enterprise" is defined to include a partnership or association in fact. 18 U.S.C. § 1961(3).

Commercial bribery under the Texas Penal Code is a felony of the third degree and is punishable by imprisonment by a term of not more than 10 years or less than 2 years. Texas Penal Code Ann. § 12.34. For acts occurring before September 1, 1983, § 32.43(b) of the Texas Penal Code provided that:

> A person who is a fiduciary commits the offense of commercial bribery if he intentionally or knowingly solicits, accepts, or agrees to accept *any* benefit as consideration for (1) violating a duty to a beneficiary, or (2) otherwise causing harm to a beneficiary by act or omission (emphasis added).

A "fiduciary" under the statute specifically includes "an agent or employee." Texas Penal Code Ann. § 32.43(a)(2)(A). A "beneficiary" is defined as "a person for whom a fiduciary is acting." Texas Penal Code Ann. § 32.43(a)(1). The Practice Commentary to § 32.43 provides "[t]he section is aimed principally *at kickbacks*." (Emphasis added.) By its terms, it also includes the receipt by an employee of any benefit if its intent is to cause a derogation of such employee's duty.

An application of the facts to the legal predicate for a § 1962(c) RICO cause of action showed that there was a person (Ehrentraut); who was employed or associated with an enterprise (Chapman & Cole); which was engaged in matters affecting interstate commerce (the construction of a shipping container yard); and who participated in or conducted the affairs of the enterprise through a pattern of racketeering activity (established by Ehrentraut's ongoing, related *multiple acts* of "commercial bribery" over at least six months under the Texas Penal Code Ann. § 32.43(b)).

Urquhart & Hassell contended Ehrentraut's multiple acts of "commercial bribery" consisted of (1) his acceptance of multiple payments from, and the benefits of a secret partnership relationship with, Novotny, a subcontractor on the Itel facility, during construction of the facility which constituted "benefits," under Texas Penal Code Ann. § 32.43(b), which were intended to and did cause Ehrentraut's violation of his duties to Chapman & Cole; (2) his improperly supervising or failure to supervise Novotny's work, which constituted "violations of duties"; and, (3) the resultant "harm" caused to his employer Chapman & Cole by reason of his actions (i.e. an improperly built facility and all the adverse consequences flowing therefrom including the dispute with Itel).

D. Petitioner's Belief That the RICO Action Was Well Grounded in Fact and Law

After conducting the foregoing inquiry into the facts and law, and forming *a good faith* belief that the actions of Ehrentraut violated the Texas Commercial Bribery statute, Texas Penal Code Section 32.43(b), and were thus a proper predicate act violation of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, et seq., Edward D. Urquhart signed and filed the

third-party complaint against Ehrentraut asserting a RICO cause of action on behalf of Itel. The district court found that the decision to maintain the RICO case against Ehrentraut "was based upon (Ms. Hassell's) subjective belief that Mr. Ehrentraut had taken kickbacks" (116 F.R.D. 556).

E. The Rulings Below

On November 5, 1984, U.S. District Judge Norman W. Black denied a motion by Ehrentraut to dismiss the lawsuit against him under Fed. R. Civ. P. 12(b). *Judge Black also denied Ehrentraut's request that Rule 11 sanctions be imposed against Itel for filing the RICO cause of action.*

On November 30, 1984, Ehrentraut filed a motion for rehearing on his motion to dismiss. On December 20, 1984, in some manner and for some reason unknown to petitioner the entire case was transferred to U.S. District Judge John V. Singleton. On January 21, 1986, Singleton denied the motion for rehearing. On May 16, 1986, Chapman & Cole and Ehrentraut filed a joint motion for summary judgment under Fed. R. Civ. P. 56 on Itel's RICO claim against Ehrentraut. On June 16, 1986, Ehrentraut once again filed another motion for Rule 11 sanctions. On August 4, 1986, Judge Singleton denied the joint motion for summary judgment on Itel's RICO claim against Ehrentraut and deferred ruling on Ehrentraut's motion for sanctions until trial. On October 16, 1986, Chapman & Cole then filed a motion for sanctions against Itel.[1]

On March 25, 1987, Ehrentraut and Itel voluntarily entered into a settlement agreement wherein Itel

1. The case degenerated to a trial by sanctions motions, devices never contemplated by this Court in promulgating Rule 11.

agreed to dismiss its claim against Ehrentraut and in turn Ehrentraut agreed to dismiss his spurious claim for sanctions against Itel. Pursuant to such settlement, on April 6, 1987, Judge Singleton ordered that Itel's action against Ehrentraut be dismissed, that the motion for sanctions of Ehrentraut be dismissed, and that the mutual cross claims between Ehrentraut and Chapman & Cole also be dismissed.

On April 15, 1987, at the conclusion of trial between Chapman & Cole and Itel, Judge Singleton ruled that no sanctions would or should be awarded against Itel or petitioner. On April 16, 1987, Chapman & Cole filed a motion to reconsider its motion for Rule 11 sanctions against Itel and petitioner, Urquhart & Hassell, for filing the RICO case against Ehrentraut and for filing a Texas Deceptive Trade Practices case against Chapman & Cole. On April 22, 1987, Ehrentraut filed another pleading styled "Supplemental Motion for Sanctions Under Rule 11" against the law firm of Urquhart & Hassell for the filing of the RICO case he had previously settled, and which had been dismissed pursuant to such settlement 16 days earlier. A show cause hearing was held May 11, 1987. On July 22, 1987, Judge Singleton entered his order granting sanctions reported at 116 F.R.D. 550, the Fifth Circuit affirmed in its opinion reported at 865 F.2d 676, and on April 17, 1989, denied petitioner's petition for rehearing and suggestion for rehearing en banc.

REASONS FOR GRANTING THE WRIT

The reasons plenary consideration of this case by the Supreme Court is warranted are three-fold: (1) the Fifth Circuit applied a test for Rule 11, that ignores a signatory attorney's "knowledge, information, and belief," which conflicts with both the wording and intent of the

amended rule and statements by this Court; (2) the Fifth Circuit's pure abuse of discretion standard of review of the imposition of Rule 11 sanctions conflicts with the principles adopted in other circuits authorizing *de novo* review of the legal conclusion that certain conduct violates Rule 11; and (3) this Court's power of supervision should be exercised in this case to prevent petitioner from being denied the right to an adequate appellate review under any standard of review. Therefore, a complete review of this case by this Court is warranted to resolve the conflicts between the various circuit courts of appeal and to provide a uniform method of measuring the conduct of attorneys under Rule 11 that is consistent with the plain wording and purpose of the amended rule. These substantial results are necessary for this Court to obtain in order to allow federal courts to uniformly apply Rule 11 in a fair and just manner, a situation that presently does not exist. Furthermore, the Fifth Circuit's decision in this case is especially in need of review by this Court because it attributes misconduct to reputable attorneys that is not in the record on appeal and did not occur and upholds sanctions for such non-existent conduct.

I. The Fifth Circuit Applied a Test for Rule 11 that Ignores a Signatory Attorney's "Knowledge, Information and Belief" Which Conflicts With the Wording and Intent of the Amended Rule and Statements by the Supreme Court.

Rule 11 on its face requires a determination whether "to the best of the signer's knowledge, information and belief" a pleading is well grounded in fact formed after a reasonable investigation. The district court imposed, and the Fifth Circuit affirmed, Rule 11 sanctions based upon their perceived strength of the RICO evidence rather than upon a determination of petitioner's knowledge, information and belief that the third-party complaint was

well grounded in fact actually formed after a reasonable inquiry. Thus, the Fifth Circuit and the district court failed to follow a proper analysis under Rule 11 and undermined Rule 11's balance between a signatory attorney's knowledge, information and belief and the reasonable investigation into the law and facts of the claim. The components of (1) an attorney's knowledge, information and belief and (2) his/her reasonable investigation into the law and facts combine to provide Rule 11's intended deterrent to litigation abuses without stifling zealous advocacy.

The Fifth Circuit and the district court imposed sanctions against petitioner based upon a misapplication of the threshold inquiry for any sanctions matter under Rule 11. Rule 11 and its official advisory commentary state, in pertinent part, the following:

> . . . The signature of an attorney or party constitutes a certificate by the signer that the signer read the pleading, motion or other paper; *that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification or reversal of existing law* and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation.
>
> . . . [T]he court is expected to avoid using the wisdom of hindsight and *should test the signer's conduct by inquiring what was reasonable to believe at the time the pleading, motion or other paper was submitted.* (Notes of Advisory Committee on Rules (1983 Amendment), Paragraph 7) (emphasis added).

This Court, in *dicta* of two decisions, has recognized these propositions as Rule 11's essential character which deters baseless allegations:

> Rule 11 of the Federal Rules of Civil Procedure, which requires pleadings to be based *on a good faith belief*, formed after reasonable inquiry that they are "well-grounded in fact," adequately protects defendants from frivolous actions.

Gwaltney of Smithfield v. Chesapeake Bay Foundation, Inc., ____U.S.____, 108 S. Ct. 376, 385, 98 L.Ed.2d 306 (1987) (emphasis added); and

> Although the pleading and amendment of pleadings rules in federal court are to be liberally construed, the administration of justice is not wellserved by the filing of premature, hastily drawn complaints. The recent revision of Federal Rule of Civil Procedure 11 *emphasizes* that an attorney or *pro se* litigant certifies that "to the best of his knowledge, information, and belief formed after reasonable inquiry [a complaint] is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law . . ."

Burnett v. Grattan, 468 U.S. 42, 104 S. Ct. 2924, 2930, fn. 13, 82 L.Ed.2d 36 (1984) (emphsais added).

This Court thus frames the Rule 11 inquiry in terms of the process (i.e. reasonable inquiry) and belief. This "process and belief" approach forms the Rule 11 paradigm for detering litigation abuse but not at the expense of advocacy. The Seventh and Eleventh Circuits also basically follow this approach to Rule 11. *See, Beeman v. Fiester*, 852 F.2d 206, 210-11 (7th Cir. 1988) ("Rule 11 states that the signature of an attorney certifies that to the best of the attorney's knowledge and belief 'formed after reasonable inquiry' the paper is 'well grounded in fact'. . . . [T]he crux of this prong of Rule 11, however, . . . is the reasonable inquiry requirement . . . Plaintiff and counsel are not required to know all the facts before they file a complaint; it is the purpose of discovery to fill in the details. 'The amount of investigation . . . depends on both

the time available to investigate and on the probability that more investigation will turn up evidence.' "); *Medical Emergency Service Associates v. Foulke*, 844 F.2d 391, 399-400 (7th Cir. 1988) *Local 983 Joint H. & W. Tr. F. v. B.R. Starnes Co.*, 827 F.2d 1454, 1458 (11th Cir. 1987) ("Courts are to avoid the *wisdom of hindsight* and are to test the signer's conduct by inquiring what was reasonable to believe at the time the pleading was submitted . . .") (emphasis added); *Donaldson v. Clark*, 819 F.2d 1551, 1556 (11th Cir. 1987).

The lower courts in this case did not follow the "process-belief" inquiry mode. The district court's statements of its chimerical inquiry, erroneously[1] accepted by the Fifth Circuit,[2] illustrates the flawed misunderstanding of the lower courts' approach:

> The law is abundantly clear: where an attorney does not have an *objectively* reasonable *basis* for filing or continuing to urge a pleading before the Court, the Court must impose some type of Rule 11 sanctions. (116 F.R.D. 552) (emphasis added);
>
> The affirmative duty placed on an attorney by Rule 11 to conduct a "reasonable inquiry" into both the factual and legal basis of any document before signing it, does not end with the filing of the pleading, motion or other document. (116 F.R.D. 553) (citation omitted);
>
> . . . sanctions "would be imposed" if [the RICO] allegations *proved* to be false . . . (116 F.R.D. 552) (emphasis added);
>
> Two separate inquiries must be made in determining whether Ms. Hassell violates her Rule 11 duty. The first is whether Ms. Hassell made a sufficient inquiry into the facts before filing the RICO claims. Then,

2. See discussion at pp. 19-23 regarding the Fifth Circuit's improper deferential standard of review of the district court's sanctions memorandum and order.

> assuming she made a sufficient initial inquiry, the second is whether she failed to re-evaluate the reasonableness of going forward with the RICO claims given the facts later discovered.[3] (116 F.R.D. 554);
>
> *It is difficult for a Court to evaluate the sufficiency of an attorney's inquiry prior to filing a claim. Such an evaluation requires the Court to delve into the attorney's initial thought processes.* For this reason it would be unfair to use hindsight as the *sole* gauge in making such an evaluation. Therefore, *in this case* the the [sic] Court must evaluate Ms. Hassell's actions *in light of the Fifth Circuit's adopted standard:* was Ms. Hassell's decision to bring the Rico claims objectively reasonable under the circumstances. (116 F.R.D. 554) (citations omitted) (emphasis added).
>
> To evaluate the sufficiency of Ms. Hassell's inquiry *one need look no further than the trial transcript.* (116 F.R.D. 555) (emphasis added).

Despite Rule 11's brevity in the statement of the "process-belief" standard, the district court labored to set forth the standard of inquiry. Yet each time the district court did not recite that the inquiry must focus on the filing attorney's belief in the facts and law and anticipation of those facts sought to be discovered later through discovery. Additionally, even assuming *arguendo* the district court can be construed to have stated the correct standard, albeit an imprecise statement of the controlling principles, the district court's opinion fails to set forth the legal and factual investigation performed by petitioner

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3. The second inquiry regarding the district court's perceived duty under Rule 11 to re-evaluate the RICO claim was rejected out of hand by the Fifth Circuit. Despite recognizing this error, the Fifth Circuit did not even discuss or consider the taint of this improper post-filing inquiry on the court's recited "pre-filing inquiry." This failure exacerbates the error on review as the district court's "pre-filing inquiry" is inexorably interwoven with the erroneous post-filing inquiry, especially regarding the perceived lack of evidence which, through a backward progression and "analysis," was the basis for the finding of an inadequate pre-filing investigation.

and why the beliefs, inferences and anticipated facts to be discovered later were unreasonable based upon the interplay between the law and facts investigated. Notwithstanding the language used or not used by the district court to express the applicable Rule 11 standard, it looked only to its perception of the strength of the facts without *prior* reference to petitioner's investigation, without *prior* reference to petitioner's beliefs (except to expressly find a subjective belief that Ehrentraut violated the RICO statute), and without *prior* reference to petitioner's statement of the controlling legal principles which were never refuted by the court, Ehrentraut or Chapman. It only reached the reasonable investigation question backwards: it determined that the court perceived no merit in the RICO claim, *ergo*, a reasonable investigation was not made.

The Fifth Circuit replicated the district court's errors.[4] It too was only concerned with the perceived strength of the evidence rather than on Rule 11's "process-belief" mode of inquiry. It is not that the Fifth Circuit has never set forth Rule 11's "process-belief" mode of inquiry, *see, Thomas v. Capital Security Services, Inc.*, 836 F.2d 868, 873-75 (5th Cir. 1988) (en banc), but petitioner would note that in this case the Fifth Circuit substituted a different standard based upon a determination of the merits of the claim rather than the "process-belief" of the claim. This substitution of the standard parallels the approach of the Second Court of Appeals which, although recognizing the "process-belief" mode of inquiry, *see, Eastway Construction Corp. v. City of New York*, 712 F.2d 243, 253 (2d Cir. 1985), relies first and foremost on a

4. The Fifth Circuit even noted a higher Rule 11 pre-filing inquiry requirement in RICO cases citing an article co-authored by U.S. District Judge Norman W. Black as authority. 865 F.2d at 685. The Fifth Circuit ignored, however, that Judge Black denied Rule 11 sanctions in this case.

determination of the merits of the argument rather than on a determination of the belief derived from a reasonable investigation. *See, Greenberg v. Hilton International Co.,* 870 F.2d 926, 934 (2d Cir. 1989) (". . . [t]he initial focus . . . should be whether an objectively reasonable evidentiary basis for the claim was demonstrated in pre-trial proceedings . . ."); *Calloway v. Marvel Entertainment Group,* 854 F.2d 1452, 1470 (2d Cir. 1988) *cert. granted* 109 S. Ct. 1116 (1989). Even in those cases where the "process-belief" mode is recognized, it appears to be acutely measured in terms of the success of the claims. *See, Oliveri v. Thompson,* 803 F.2d 1265, 1275 (2d Cir. 1986); *Eastway Construction Corp. v. City of New York,* 762 F.2d at 254.

The substitution trend may potentially be widespread. Its "merit/argument" focus is the direct or natural development of the pure objective-prudent attorney approach principally articulated in *Eastway Construction Corp. v. City of New York*, 712 F.2d at 254, which, in turn, has been adopted, in whole or in part, in the majority of the circuits. Moore, Lucas and Grotheer, *Moore's Federal Practice*, Section 11.02(3), p. 11-20 (Matthew Bender, 1989) (hereafter "Moore"); Elson and Rothschild, "Rule 11: Objectivity and Competence," 123 F.R.D. 361, 362 (1989) (hereafter "Elson and Rothschild"). The net result of such a trend (1) is the adoption of a standard which *amends* Rule 11 simply becuse such standard cannot be reconciled with Rule 11's text, Moore, Section 11.02[3] ("*Although the Rule itself does not use the term,* [this] standard of 'frivolousness' is generally used . . ."); Elson and Rothschild, 123 F.R.D. at 363 ("To mandate sanctions irrespective of the signer's knowledge, information and belief, irrespective of whether the signature is the product of innocence, negligence or design, cannot really be reconciled with what the Rule says."); (2)

which extols product over process: where product should be the domain of Rules 12 and 56, Fed. R. Civ. P., Schwarzer, "Rule 11 Revisited," 101 Harv. L. Rev. 1011, 1018-19 (1988) (hereafter "Schwarzer"); Elson and Rothschild, 123 F.R.D. at 363; (3) which is not based upon an interpretive rationale and, in turn, breeds confusion and uncertainty, Schwarzer, 101 Harv. L. Rev. at 1016-18; and (4) which creates satellite litigation, chills advocacy and diminishes professionalism, Elson and Rothschild, 123 F.R.D. at 364-6.

Rule 11's "process-belief" approach allows lawyers to file pleadings based upon a reasonable belief in the law and in facts formed after a reasonable investigation. The "merit/argument" approach subverts this process. Instead, it allows an attorney to be second guessed by the courts regarding the ultimate merits of a claim; it allows and requires courts to second guess other courts; and provides an attorney no "safe-harbour" because an attorney's view of the state of the evidence can be unilaterally challenged post facto by unfettered hindsight judicial review.

The lower court's refusal to discuss petitioner's reasonable belief in law and in fact based upon reasonable investigation into the law and facts is manifest error. It is unclear whether that belief must be purely objective or may, in part, have a subjective component, namely the visceral evaluation of facts inherent in the practice of law. It has been argued that the pre- and post- 1983 version of Rule 11's reliance on an attorney's knowledge, information and belief necessarily encompasses a subjective component. Vairo, "Rule 11: A Critical Analysis," 118 F.R.D. 189, 195 (1988) ("Substantively, notwithstanding the Advisory Committee's intentions, both the language of the amended role and the Advisory Committee notes contain highly subjective elements."); Elson and Rothchild, 123 F.R.D. at 362-3. In this regard the 1983 amend-

ments to Rule 11 kept the language generating the pre-1983 Rule 11 subjective analysis. *Nemeroff v. Abelson,* 620 F.2d 339, 350 (2d Cir. 1980); *But see, in re Ronco, Inc.,* 105 F.R.D. 493, 495 (N.D. Ill. 1985) and *Badillo v. Central Steel and Wire Co.,* 717 F.2d 1160, 1166 (7th Cir. 1983), and added to the "knowledge, information and belief" shell of the pre-1983 Rule 11 the objective reasonable investigation requirement. T.E. Willging, "The Rule 11 Sanctioning Process" 1, 19 (Federal Judicial Center 1988); Underwood, "Curbing Litigation Abuses: Judicial Control of Adversary Ethics—the Model Rules of Professional Conduct and the Proposed Amendments to the Rules of Civil Procedure," 56 St. John's L. Rev. 625, 643-45; Elson and Rothschild, 123 F.R.D. at 363; *Brown v. Federation of State Medical Boards of U.S.,* 830 F.2d 1429, 1435 fn. 4 (7th Cir. 1987). Apparently, a pre-1983 Rule 11 good faith belief is *no* longer an automatic defense, but that conclusion does not mean that all subjective components are eliminated. If they are, the lower courts have arrogated to themselves control of the adversary system, a result not contemplated by this Court in 1983.

The net result may have to be a hybrid test. *See, Eastway Construction Corp. v. City of New York,* 637 F. Supp. 558, 567 (E.D. N.Y. 1986) *mod.* 821 F.2d 121 (2d Cir. 1987) ("the text suggests that the obligation imposed by the Rule is partly objective, and partly subjective . . . Since the certification relates to the attorneys' own beliefs, it appears that it should be judged by a subjective standard. Even the subjective component has objective aspects . . .); *Davis v. Veslan Enterprises,* 765 F.2d 494, 498 fn. 4 (5th Cir. 1985); *In re Ginther,* 791 F.2d 1151, 1155 (5th Cir. 1986); *Stites v. I.R.S.,* 793 F.2d 618, 620 (5th Cir. 1986). Notwithstanding the resolution of the possible subjective-objective mix of a

Rule 11 belief, the lower courts in this case have failed to consider any mix, except to deny *any* effect to petitioner's belief.

II. The Fifth Circuit's Pure Abuse of Discretion Standard of Review of the Imposition of Rule 11 Sanctions Conflicts With the Adoption in Other Circuits of a Review *De Novo* of the Legal Conclusion that Certain Conduct Violates Rule 11.

Rule 11 provides, "If a pleading, motion, or other paper is signed in violation of [Rule 11], the court, upon motion or its own initiative, *shall* impose upon the person who signed it, a represented party, or both, an appropriate sanction . . ." (emphasis added). If a district court appropriately determines that Rule 11 has been violated therefore, it has no choice—it must impose sanctions. It is this lack of discretion in a district court that makes appellate review of an imposition of Rule 11 sanctions under a pure abuse of discretion standard not warranted.

Had Rule 11 sanctions been sought on petitioner in the Ninth Circuit the decision would have been subject to a more exacting review. Specifically, the review conducted in the Ninth Circuit is a three pronged review as follows:

> If the facts relied upon by the district court to establish a violation of the Rule are disputed on appeal, we review the factual determinations of the district court under a clearly erroneous standard. If the legal conclusions of the district court that the facts constitute a violation of the Rule 11 is disputed, we review that legal conclusion *de novo*. Finally, if the appropriateness of the sanction imposed is challenged, we review the sanction under an abuse of discretion standard.

Zaldivar v. City of Los Angeles, 780 F.2d 823 at 828 (9th Cir. 1986).

Similarly, the D.C., Second, Eighth and Eleventh Circuit Courts of Appeal conduct a three pronged review of Rule 11 sanctions different only from the Ninth Circuit in that the review of factual findings supporting the imposition of sanctions are reviewed for abuse of discretion rather than for clear error. *Westmoreland v. C.B.S.*, 770 F.2d 1168, 1175 (D.C. Cir. 1985); *Eastway Construction Corp. v. City of New York*, 762 F.2d 243, 254 n. 7 (2nd Cir. 1985), cert. denied ____U.S.____, 108 S. Ct. 269 (1987); *Kurkowski v. Volcker*, 819 F.2d 201 (8th Cir. 1987); *Donaldson v. Clark*, 819 F.2d 1551, 1556 (11th Cir. 1987) *en banc*. (The Eighth Circuit initially adopted a single abuse of discretion standard in *Gelco Corp. v. Baker Indus., Inc.*, 779 F.2d 26, 28 (8th Cir. 1985), but in more recent cases has adopted the three pronged standard of review including a *de novo* review of the legal conclusion that a violation of Rule 11 has occurred. *Kurkowski v. Volcker*, 819 F.2d 201 (8th Cir. 1987); *E.E.O.C. v. Milavetz and Associates, P.A.*, 863 F.2d 613 (8th Cir. 1988).)

The Fifth Circuit's review of Rule 11 sanctions conflicts with the Ninth, D.C., Second, Eighth and Eleventh Circuits and some Seventh Circuit decisions in that it examines the opinion on a single abuse of discretion standard. *Thomas v. Capital Security Services, Inc.*, 836 F.2d 866 (5th Cir. 1988) (en banc). The Fifth Circuit's use of a single "deferential" abuse of discretion standard rather than a "more demanding differentiated" approach, *Id.* at 871-872, is also the standard used by the First, Third, Fourth, Sixth and Tenth Circuits. *Kale v. Combined Insurance Co. of America*, 861 F.2d 746 (1st Cir. 1988); *Lieb v. Topstone Indus., Inc.*, 788 F.2d 151, 157 (3rd Cir. 1986); *Cf. Snow Machines, Inc. v. Hedco, Inc.*, 838 F.2d 718, 724-25 (3rd Cir. 1988); *Stevens v. Lawyers Mutual Liability Insurance Co.*, 789 F.2d 1056, 1060

(4th Cir. 1986); *Century Products, Inc. v. Sutter,* 837 F.2d 247, 253 (6th Cir. 1988) (*But see* concurring opinion of Sixth Circuit Judge David A. Nelson advocating a *de novo* review of the legal determination that a violation of Rule 11 has occurred.); *Cotner v. Hopkins,* 795 F.2d 900, 903 (10th Cir. 1986).[5]

The Fifth Circuit adopted the single abuse of discretion standard despite its simultaneous recognition that "the imperative character of the language 'shall impose' in the rule carries with it the natural concomitant that mandatory sanctions broaden the scope of appellate review . . ." *Thomas v. Capital Security* at 872. As opposed to applying a broader appellate review in this case, however, the Fifth Circuit's review of the imposition of Rule 11 sanctions was so deferential to the discretion of the district court that it accepted, virtually without question or accurate examination, the erroneous legal conclusion that the actions of Urquhart & Hassell violated Rule 11.

The appeals court further ignored the district court's admitted use of impermissible trial hindsight (116 F.R.D. 555) in reaching its conclusion, and that such hindsight was astonishingly tainted by the district court's refusal to allow cross-examination at trial on the RICO issues because that claim had been settled (despite allowing Chapman & Cole to elicit self-serving testimony on direct examina-

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5. The Seventh Circuit has established a three prong standard of review similar to that of the Ninth Circuit. *Brown v Federation of State Medical Boards,* 830 F.2d 1429, 1434 (7th Cir. 1987) (citing *Szabo Food Serv., Inc. v. Canteen Corp.,* 823 F.2d 1073 (7th Cir. 1987), cert. dismissed, ____U.S.____, 108 S. Ct. 1101, 99 L.Ed.2d 229 (1988)). However, other recent Seventh Circuit cases have held the district court's legal determination that sanctions are appropriate are reversible only upon finding abuse of discretion by the district court. *Schaefer v. Transportation Media, Inc.,* 859 F.2d 1251, 1256 (7th Cir. 1988); *F.D.I.C. v. Tekfen Constr. & Installation Co.,* 847 F.2d 440, 442-43 (7th Cir. 1988). The Seventh Circuit is currently considering, *en banc,* the appropriate standard of review. *Mars Steel Corp. v. Continental Illinois National Bank and Trust Co.,* No. 88-1554 (7th Cir. Feb. 16, 1989).

tion). Such hindsight was not used by Judge Black in denying Rule 11 sanctions for the filing of the lawsuit against Ehrentraut because he made his Rule 11 inquiry at the time it was filed and at the time he considered and denied a Rule 12(b) motion to dismiss, over two and one-half years prior to Judge Singleton's incredulous ruling on a settled, non-tried issue or claim. In addition, the Fifth Circuit did not even comment on the district court's failure to recognize or consider the relevant circumstances raised by petitioner surrounding the initial inquiry into the RICO claims. Such circumstances included the fact that the direct evidence regarding the RICO claims was mainly in the hands of hostile third-parties with their own interests to protect and the irreconcilable pre-filing deposition testimonies of Ehrentraut and Howard Chapman on the subject of whether Ehrentraut was fired and for what reason.

The presently existing lack of a discernible standard of interpretation of Rule 11 and standard of appellate review has resulted in the granting and upholding of Rule 11 sanctions in this case on facts twice before considered by district judges in light of Rule 11 and twice before found not in violation of Rule 11. Given such a variance, even within the same court, an attorney's determination that he is in compliance with Rule 11 plainly is just a Las Vegas gamble. In any event, it is hardly a predictable risk that lawyers should be required to encounter.

The Ninth Circuit recognizes the "risk when mandatory sanctions ride upon close judicial decisions. The danger of arbitrariness increases and the probability of uniform enforcement declines." *Golden Eagle Distributing Corp. v. Burroughs*, 801 F.2d 1531 (9th Cir. 1986). Such a risk underscores the need for a uniform and more stringent review of whether the district court's conclusion that facts deemed to violate Rule 11 do, in fact, violate the Rule.

This need is especially urgent in that there presently exists no uniform, discernible standard of interpretation of the dictates of Rule 11. Given the harm that can (and often does) result to an attorney's professional reputation by the publication of a court opinion that an attorney's conduct was sanctionable, this Court should grant certiorari to determine the proper standard of appellate review in Rule 11 cases.

III. The Supreme Court's Power of Supervision Should be Exercised in this Case to Prevent Petitioner from Being Denied the Right to an Adequate Appellate Review.

Petitioner contends the Fifth Circuit's review of the imposition of sanctions in this case is inadequate to the extent that the Fifth Circuit "has so far departed from the accepted and usual course of judicial proceedings . . . as to call for an exercise of this Court's power of supervision" pursuant to Supreme Court Rule 17.1(a).

A. The Fifth Circuit Decision is Based on the Fundamental Misapprehension that a RICO Counterclaim Was Filed and Tried Against Chapman & Cole When no Such Counterclaim Was Ever Filed Against Chapman & Cole and Was Never Tried Against Any Party.

The danger in not requiring a more effective in-depth appellate review of Rule 11 sanctions than is called for under an abuse of discretion review is pointedly demonstrated by the Fifth Circuit's decision in this case. Throughout the Fifth Circuit's decision it erroneously assumed that petitioner filed a counterclaim under RICO against Chapman & Cole, when no such counterclaim was ever filed, is not in the record on appeal, and was *never tried against any party*. The Fifth Circuit decision, therefore, upholds sanctions against petitioner for signing a

document under Rule 11 that never existed, was not in the record on appeal, and cannot, therefore, be based on any proper appellate review of the case. The Fifth Circuit's decision incorrectly recites in six different places that Itel's counterclaim against Chapman & Cole included a RICO action. For example, the Fifth Circuit states:

> Itel counterclaimed alleging that Chapman [& Cole] had failed to design and construct the container yard adequately and alleging a RICO violation by Chapman [& Cole] . . .

865 F.2d at 678. Also, see the other five (5) incorrect recitations regarding the counterclaim at 865 F.2d 680 and 683. The Fifth Circuit's erroneous assumptions that a RICO case was filed and tried against Chapman & Cole caused it to erroneously reason that petitioner was given an opportunity to present evidence of the RICO claim during trial notwithstanding no RICO claim was ever tried and the district court ruled at the commencement of the trial that it was *not going "to hear any evidence on the RICO issue."* (T. 23, lines 11-13) (emphasis added). The Fifth Circuit even mis-stated that "Itel also was repeatedly warned throughout the trial of the possibility of sanctions" in the context of its continuing erroneous assumption that a RICO action was being tried at the trial. 865 F.2d at 684. This Court's heavy docket should not be reason for overlooking this travesty in the adversary system.

When an appellate court, as in this case, bases its affirmance of the imposition of Rule 11 sanctions on *a case that was never brought nor tried*, in sum a pleading that was not signed nor filed, there has not been a proper exercise of appellate review of such sanctions under any standard of review and the appellant has been denied a right to an effective and adequate appeal. This egregious error was

brought to the attention of the Fifth Circuit in petitioner's petition for rehearing and suggestion for rehearing en banc. The Fifth Circuit refused to correct its own errors in the very teeth of these presented contentions.

B. Rule 11 Sanctions are Not Appropriate When a Previously Assigned Judge Holds that Rule 11 Sanctions are Not Warranted.

Prior to this case being transferred to Judge John V. Singleton, Jr., Judge Norman W. Black reviewed the same pleading filed by petitioner in light of both Rules 11 and 12(b), denied Ehrentraut's request for Rule 11 sanctions, denied his 12(b) motion to dismiss, and permitted the filing of the only RICO claim that was ever filed in this case even beyond the deadline for bringing in additional parties to the suit, i.e., the "Third-Party Complaint."

(Even Judge Singleton denied a motion to reconsider the denial of Ehrentraut's Rule 12(b) motion and also denied Rule 56 motions for summary judgment of the RICO claim.) It is a gross miscarriage of justice for the Fifth Circuit to uphold sanctions against petitioner and never to address or explain why it ignored the fact that the prior district judge granted leave of court for the late filing of the RICO action and ruled that the filing thereof did not warrant Rule 11 sanctions after he reviewed the pre-filing inquiry conducted by petitioner. Under no circumstances or any standard of review are Rule 11 sanctions appropriate in this situation. There has been a farcical application of sanctions in this case. Is it possible this Court will countenance the "standards" applied in the courts below?

C. The Fifth Circuit Failed to Recognize the District Court's Fundamentally Erroneous Basis for Granting Sanctions.

The Fifth Circuit also repeated as a basis for sanctions

the position of the district court that the RICO case was based on a link between payments received by Ehrentraut and subcontract work performed by *Robert Treat* on the flexible surface of the storage yard. 865 F.2d at 680, 684, 685. However, petitioner's repeated explanations of its underlying basis for the RICO claim was that the "benefits and payments" Ehrentraut secretly received from Novotny and Dantex Erectors were for the purpose of influencing Ehrentraut's conduct toward the subcontract concrete *work performed by Novotny*, not Treat's work on the flexible surface. It is inadequate and illogical for an appellate court to hold that a secret partnership arrangement between Ehrentraut and a subcontractor, and secret payments therefrom, would not support a RICO claim because there was no link established between the payments from that subcontractor, i.e., Ehrentraut's secret partner, and an entirely unrelated subcontractor (Treat) who constructed an entirely different aspect of the project. To hold that payments from one subcontractor (Novotny) to an employee, Ehrentraut, cannot form the basis for a RICO claim unless a link is established with the different work of another subcontractor is struthiously nonsensical. Both the district court and the Fifth Circuit engaged in such fallacious reasoning, and while the reasons for their doing so are not readily ascertainable, the bottom line is that petitioner has been denied a fair hearing and appeal because of the flawed analysis of both courts.

D. The Fifth Circuit Failed to Recognize that the Discovery it Upheld as Being Unnecessary Under Rule 26(g) Primarily Constituted the Pre-filing Inquiry on Which Judge Black Permitted the Filing of the Third-Party RICO Claim and Was All Necessary With Regard to the Non-RICO Claims Involved.

The district court's imposition of Rule 26(g) sanctions for discovery abuse, and the Fifth Circuit's review thereof,

is totally based on their first reaching the erroneous conclusion that there was a Rule 11 violation. The district court and the Fifth Circuit ruled certain deposition testimony as unnecessary, and therefore abusive, as a result of their conclusion that the RICO claim should not have been filed. Furthermore, the district court and the Fifth Circuit did not even address and wholly ignored petitioner's argument that the discovery the district court ruled as unnecessary was absolutely necessary and relevant to the non-RICO claims involved, i.e., the opposing contractual claims and the D.T.P.A. claim against Chapman & Cole, *which Judge Singleton simultaneously ruled did not warrant sanctions,* and that most of such discovery was even conducted prior to filing the RICO claim. All of the witnesses listed as being unnecessarily deposed by the Fifth Circuit had distinct roles in the planning, designing, construction, failure or rebuilding of the Itel facility, i.e., matters clearly necessary for the non-RICO claims between the parties. In fact, the deponents named by the Fifth Circuit as being unnecessarily deposed included Ehrentraut and Montgomery who were also noticed and deposed simultaneously by Chapman & Cole's attorney! (R. 2257, 2255). Such clearly erroneous and unexplainable holdings by the Fifth Circuit, combined with its other misapprehensions described herein, reflect that petitioner has not been afforded its right to an effective appeal which warrants the exercise of this Court's power of supervision.

E. The District Court and the Fifth Circuit Failed to Make a Proper Determination Regarding the Sanctions Imposed Under Fed. R. Civ. P. 37(d).

During the inquiry conducted by Urquhart & Hassell, attorney Hassell telephoned the architect of the project, Montgomery, regarding the facts of the case. In the course

of such telephone conversation Montgomery informed Hassell that he would commit perjury if questioned about his comments to her in front of anyone. At that time Hassell considered it her affirmative duty to her client and the court to prevent perjured testimony and thus began to record the conversation without informing Montgomery. Montgomery repeated, during the partial taping, that he would commit perjury regarding the facts. Following such conversation petitioner deposed Montgomery regarding the statements made during the telephone call. Montgomery admitted under oath and on the record that he had heard Ehrentraut was receiving money from a subcontractor on the Itel job and that the information had come from Lester Schallit, Howard Chapman's partner and longtime friend. He further admitted he may have "jokingly" told Hassell he would commit perjury. Thereafter, Chapman & Cole propounded an interrogatory to petitioner regarding the allegations in the RICO complaint against Ehrentraut. Petitioner concluded, in good faith, that the tape was not responsive to the interrogatory because petitioner believed the interrogatory to be requesting evidence of kickbacks and considered the tape to be the equivalent of attorney notes taken during an interview, *i.e.*, not evidence. Nor did it constitute "evidence" as such.

Urquhart & Hassell revealed the existence of the tape at the conclusion of the trial between Itel and Chapman & Cole at a point when Judge Singleton was questioning in-house counsel for Itel as to why the RICO action against Ehrentraut was brought, and why she had believed her attorney's statements regarding what Montgomery had said. The tape was then requested by Chapman & Cole. Petitioner produced the tape *in camera*, objecting to its production to Chapman & Cole. *The district court denied Chapman & Cole's request for the tape.* In addi-

tion, the district court (and later the Fifth Circuit) ruled that the partial tape recording contained "only rumors" and "unverified hearsay." 865 F.2d at 684, 685. However, the district court ruled that petitioner's interpretation of the interrogatory was not objectively reasonable, and that only a small portion of the tape contained work product. The district court also ruled that failure to produce the tape "needlessly prolonged the litigation of defendant's meritless RICO claim" and for that reason sanctions were imposed.

The lower courts, however, ignored the fact that all parties were aware of Montgomery's statements directly because he was questioned at his deposition about stating to Hassell that he had heard Ehrentraut had taken payments. His deposition was taken prior to the filing of the RICO claim and prior to the propounding of the interrogatory in question. Patently, the failure to identify the tape could not have been for the purpose of concealing Montgomery's statements since they had already been revealed at his deposition. In sum, identifying the tape would no more have affected the litigation than Montgomery's pre-filing deposition did as all parties had access to his deposition testimony. Rule 37(d) provides that sanctions thereunder are not proper if the failure to comply with a discovery request was substantially justified or if other circumstances make an award of expenses unjust. Under the circumstances of this case, Rule 37 sanctions against petitioner are undeniably unjust and the Fifth Circuit's inadequate or non-existent review thereof is clear error.

It is clear that the district court and Fifth Circuit's upholding of discovery sanctions under Rules 26 and 37 was based on their first, but erroneous conclusion that there was a Rule 11 violation. Even if the erroneously perceived Rule 11 violation was not the *basis* for awarding

and upholding Rules 26 and 37 sanctions, however, it is undeniable that such imposition and upholding was so tainted by the prior Rule 11 determination that a fair and unbiased determination was not made under the other rules.

CONCLUSION

The Fifth Circuit and those circuits that have aligned themselves with it are in disregard of the plain wording of Rule 11. In addition, the taint and stigma of an erroneous Rule 11 finding should not be allowed to permeate an entire opinion as in this case. When attorneys are denied an effective and adequate appellate review of sanctions imposed upon them for seeking relief on behalf of a client in a federal court, not only are such attorneys improperly denied due process, but the rights of the public in general to representation by attorneys in federal court are damaged. And, at least to litigators, the chilling effect on the adversary system is neither imaginary nor purely resistive to the increasingly dangerous assumptions of power over the trial of disputed controversies. For the reasons stated herein, petitioner respectfully prays that this petition be granted and that the decisions of the district court and Fifth Circuit be reversed. The issue is quintessential to the judicial system. At least appropriate Rule 11 standards should be announced by this Court.

Respectfully submitted,

W. JAMES KRONZER
1001 Texas Avenue
Suite 1030
Houston, Texas 77002
(713) 236-1722
Counsel of Record for Petitioner

APPENDIX A

CHAPMAN & COLE and CCP., Ltd.,
Plaintiffs-Counter Defendants,
Appellees-Cross Appellants,

v.

ITEL CONTAINER INTERNATIONAL B.V.
and Itel Containers International Corp (ITEL),
Defendants-Counter Plaintiffs, Third Party Plaintiffs,
Appellants-Cross Appellees.

URQUHART AND HASSELL,
Attorneys for Itel Container International B.V., et al.,
Appellants,

v.

Norman EHRENTRAUT,
Third Party Defendant-Appellee.

No. 87-2973.

United States Court of Appeals,
Fifth Circuit.

Feb. 17, 1989.

Lessor brought action against lessee for breach of commercial lease of container yard. The United States District Court for the Southern District of Texas, John V. Singleton, Jr., Chief Judge, 665 F.Supp. 1283, held for lessor, and lessee appealed. The Court of Appeals, Jerre S. Williams, Circuit Judge, held that: (1) evidence supported finding that lessee breached lease, and (2)

imposition of sanctions against lessee and its counsel was warranted.

Affirmed.

Silvia T. Hassell, Edward D. Urquhart, Houston, Tex., David R. Noteware, Laurie Doré, Dallas, Tex., for Itel Container Intern. B.V.

William G. Rosch, III, Houston, Tex., for Urquhart & Hassell.

J. Douglas Sutter, Houston, Tex., for Chapman & Cole.

Fritz Barnett, Mary Kay Klimesh, Houston, Tex., for Ehrentraut.

Appeals from the United States District Court for the Southern District of Texas.

Before GEE, SNEED* and WILLIAMS, Circuit Judges.

JERRE S. WILLIAMS, Circuit Judge:

This action arose over the commercial lease of a container yard. Chapman & Cole (Chapman), the landlord, brought this suit seeking recovery for failure to pay rent and failure to maintain the premises properly against Itel Container International B.V. (Itel), the tenant. Itel counter-claimed alleging that Chapman had failed to design and construct the container yard adequately and alleging a RICO violation by Chapman and one of its employees, Mr. Norman Ehrentraut.

Itel appeals the final judgment award of $562,573.62, plus costs and expenses and attorneys fees in favor of

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* Circuit Judge of the Ninth Circuit, sitting by designation.

Chapman in the case-in-chief, the breach of contract claim. Itel and Urquhart & Hassell, Itel's counsel for the case-in-chief, appeal the sanctions imposed against them under Federal Rules of Civil Procedure 11, 26, and 37. Chapman also appeals two portions of the judgment: the denial of future rent damages in the breach of contract claim, and the application of the post-judgment interest rate of 7%, the rate set out in the Miller Act.

We deny Itel's and its counsels' appeals and also Chapman's appeals, affirming in its entirety the district court judgment.

I. FACTS AND PRIOR PROCEEDINGS

Itel is in the business of owning, leasing, storing, and moving large aluminum and steel containers all over the world.[1] After deciding to establish a container yard in Houston in late 1979, Itel contacted Coldwell Banker to find an investment builder who would assist in the development and construction of a yard.

Coldwell Banker enlisted Chapman to purchase property for the site, develop it pursuant to plans and specifications approved by both Chapman and Itel, and lease the property back to Itel for a term of ten years. Itel at the end of the lease was then to have an option to purchase the yard.

Chapman purchased the property, and the yard was built through the use of subcontractors. Chapman referred Itel to Mr. Robert Treat, a "dirt/surface subcontractor,"

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1. Itel is the fourth largest container company in the world. Itel utilizes various container yards in the United States, including yards in Chicago, Detroit, Houston, Los Angeles, Memphis, Oakland, Portland, and Seattle.

and to Mr. John Montgomery, an architect. Itel representatives met with Treat and Montgomery on numerous occasions to plan, develop, and design the facility.

During the planning stage, Itel advised Chapman and the subcontractor Treat that the maximum weight to be utilized on the yard would be 30,000 pounds.[2] The maximum amount of weight was important because the yard needed to be constructed to withstand that weight Itel also advised them that the containers would be stacked on timber rails to allow for proper drainage and to prevent damage to the flexible surface that was chosen for the site. Pursuant to these advices, the yard was constructed.

In June of 1980, Coldwell Banker, as the agent of Itel, prepared a standard industrial/commercial lease and lease addendum that were signed by Itel as the lessee and Chapman as the lessor. The lease was later amended to state it would begin on February 1, 1981 and end on January 31, 1991. The lease and the addendum are the only written agreements between the parties. They were the subject of a joint stipulation by the parties when they were admitted into evidence at trial.[3]

Upon completion of the site in early January 1981, Itel took possession. At the grand opening of the facility in March 1981, Itel declared to the public that it had

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2. Itel contends that it is understood in the container business that 30,000 pounds refers to the lift capacity and not the gross weight as Chapman assumed. Itel further contends that even if 30,000 pounds referred to the gross weight, the surface still would not have been able to withstand the weight.

3. The relevant sections of the lease can be found in the district court opinion, *Chapman & Cole v. Itel Container International,* 665 F.Supp. 1283, 1286-88 (S.D. Texas 1987).

"designed the greatest facility that this type operation could possibly have."

Itel hired an independent contractor to operate the plant on its behalf. After analyzing the flexible surface material of the plant, the independent contractor informed Itel that the surface could not withstand the weight of the forklifts Itel planned to use. Itel instructed the contractor to use the forklifts as planned anyway.[4] During the first weekend of operations, 1200 containers were placed on the yard. Up to 12,000 were moved on and then off the yard in the ten months Itel had possession of the yard.

During the first month of operation, failures in the surface were already appearing. Upon request by Itel, Chapman, through its subcontractors, made the necessary repairs to the surface. Upon discovering the weights of the forklifts being used on the facility however, Chapman, as well as the subcontractors, refused to make any further repairs after May 15, 1981.

Itel ceased to pay rent on July 1, 1981, remaining on the yard until October 1, 1981. In the face of the contract obligations under the lease and despite substantial damage obviously occurring to the yard, Itel did not make repairs or maintain the yard.

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4. Itel initially advised Chapman that a "top" forklift would be utilized in the yard to preclude damage to the flexible surface that would be caused by the tynes of a "bottom" forklift. However, Itel only had the "bottom" forklifts on hand upon the opening of the plant so that they had to be used. These forklifts weighed approximately 48,000 pounds and could exert as much as 80,000 pounds of weight on any given location. This weight was 214% greater than the maximum 30,000 pound weight for which the container yard had been designed.

After Itel vacated the property, Chapman undertook repairs. During the renovation, Chapman leased half of the property to Container Maintenance Service (CMS). After renovation, CMS occupied the entire space until 1985 when it went into bankruptcy. The property was then relet to another contractor who also became insolvent and was never able to make any rent payments. The yard has not been relet since.

On November 22, 1982, Chapman sued Itel in the United States District Court for breach of the lease. Chapman claimed that Itel's alleged use of overweight forklifts, its failure to stack containers properly, and its careless maintenance of the yard negligently damaged the yard's surface and appurtenances in breach of the lease contract.

Itel answered and counterclaimed for breach of an alleged turn-key lease, breach of warranty, negligence, and violation of the Deceptive Trade Practices-Consumer Protection Act ("DTPA"), Tex. Bus. & Com. Code Ann. 17.41, *et seq.* Itel alleged that Chapman failed to complete the facility adequately to support Itel's normal operations; thus, Itel was constructively evicted by these deficiences.

Two years into the case, Itel amended the counterclaim, alleging violation of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1961, *et seq.*, because of alleged violation of the Texas Commercial Statute, Tex. Pen. Code Ann. 32.43 (pre-1983). In its counterclaim, it joined Ehrentraut as a third party defendant. Ehrentraut was Chapman's supervisor for the Itel project. Itel dismissed its claim with prejudice against Ehrentraut the day before trial was to begin because of a settlement agreement with him.

Itel contended in the counterclaim that Ehrentraut had received "kickbacks" by a Mr. Ed Novotny of Dantex Erectors, one of the subcontractors on the project, to "turn his head" during the construction of the surface of the facility by Treat, another subcontractor. While it is clear Ehrentraut did receive at least five checks from Dantex Erectors during the time period in question, the evidence established that these checks were paid to Ehrentraut for other legitimate business transactions completely unrelated to the matter at hand.

After a trial which lasted seven days, the district court entered its findings of fact and conclusions of law. The court awarded Chapman $562,573.72 in actual damages, pre- and post-judgment interest, $13,412.06 in costs and expenses, and $180,000 in attorneys' fees. No future damages were awarded. The court also dismissed Itel's counterclaim with prejudice. Final judgment issued on August 10, 1987.

The court characterized this case as a "straightforward action for breach of contract," in finding that Chapman had constructed the yard in accordance with the specifications prepared by Itel. It concluded that it was through Itel's failure to maintain the property that damage occurred to the property.

After trial and after a "show cause" hearing, the district court imposed sanctions against Itel and its attorneys. On July 22, 1987, the Court ordered Itel and Urquhart & Hassell to pay appellees $20,000 in sanctions, allocating $15,000 to Chapman and $5,000 to Ehrentraut. The court found that Itel and its attorneys had violated Federal Rule of Civil Procedure 11 by failing to make an objectively reasonable inquiry regarding the third party

RICO action. The court further held that Itel's attorneys abused the discovery process, holding them liable under Federal Rules of Civil Procedure 27 and 36 for unnecessary discovery requests and for failure to disclose the existence of a taped conversation between one of Itel's attorneys and John Montgomery, a witness in the case.

II. BREACH OF CONTRACT CLAIM

A. *Standard of Review*

Our review of the facts is limited by the clearly erroneous rule set out in Federal Rule of Civil Procedure 52(a).[5] The court found Chapman to be an "honest and credible" witness with a "straightforward claim for breach of contract." Since the district court was in the best position to determine the nature of the parties' negotiations and understandings, basing its findings on witness credibility, we defer strongly to this finding. *See Anderson v. Bessemer City*, 470 U.S. 564, 575, 105 S. Ct. 1504, 1512, 84 L.Ed.2d 518 (1985).

[1] As to the lease itself, the district court found the contract clear and unambiguous. Because of the absence of factual issues, our interpretation of the contract is not limited to the clearly erroneous rule. *Carpenters Amended & Restated Health Ben. Fund v. Holleman Constr. Co.*, 751 F.2d 763, 766 (5th Cir. 1985). Where there is no ambiguity, the construction of the contract

5. Rule 52(a) governs findings of fact in bench trials:
Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge of the credibility of the witnesses.
Fed. R. Civ. P. 52(a).

evidencing the expressed intentions of the parties is a matter of law for the court, and it calls for *de novo* review on appeal. *Austin v. Decker Coal Co.*, 701 F.2d 420, 425 (5th Cir.), *cert. denied*, 464 U.S. 938, 104 S. Ct. 348, 78 L.Ed.2d 314 (1983). The objective intentions of the parties from a review of the written language of the contract control regardless of whether it actually reflects the subjective intentions as well. *Pinehurst v. Spooner Addition Water Co.*, 432 S.W.2d 515, 518 (Tex. 1968); *see also Carpenters Amended*, 751 F.2d at 766.

B. *The "Turn-key" Provision*

On appeal, Itel argues that the district court's finding that this case involves a straight-forward breach of contract claim misapprehended the "turn-key" nature of the contract. Itel supports this argument by pointing out the trial court in its written opinion never addressed specifically the typewritten lease addendum that expressly required Chapman to construct the Itel facility on a "turn-key condition upon occupancy" basis so that Itel "would have the capacity to immediately commence [its] normal operations."[6]

[2] A "turn-key" contract has a certain well-defined meaning in law and in fact. A "turn-key job is defined as 'a job or contract in which the contractor agrees to complete the work of the building and installation to the point of readiness for operation or occupancy.' " *Hawaiian Independent Refinery, Inc. v. United States*,

6. While the court never mentions the term "turn-key" in its opinion, it is clear that the court was aware of the provision because of the many references by the court to the addendum. We must conclude that the court chose to disregard the general industry usage meaning of the term in its conclusions.

697 F.2d 1063, 1065 n. 4 (Fed. Cir.), *cert. denied*, 464 U.S. 816, 104 S. Ct. 73, 78 L.Ed.2d 86 (1983) (citing to Webster's Third New International Dictionary (1971 ed.)). The developer "assumes all risks incident to the creation of a fully completed facility," *Securities & Exchange Commission v. Senex Corp.*, 399 F.Supp. 497, 500 n. 1 (E.D. Ky. 1975), *aff'd*, 534 F.2d 1240 (6th Cir. 1976), and must bear "the risk for all loss and damage to the work until its completion and acceptance." *Chemical & Industrial Corp. v. State Tax Com.*, 11 Utah 2d 406, 360 P.2d 819, 820 (1961). Itel's "normal business operations" were contractually described in both the addendum and the lease: the premises were to be used "as a depot for containers, chassis and other transportation equipment."

[3] While Chapman admits its obligation to build a facility capable of Itel's intended use, this admission, along with the use of the term "turn-key" in the contract, did not create a "turn-key" situation. The district court correctly looked to the entire written agreement to ascertain the meaning of the contract and did not err in disregarding the industry usage of the term "turn-key." *See Chapman v. Orange Rice Milling Co.*, 747 F.2d 981, 983 (5th Cir. 1984); *see also Glassman Constr. Co. v. Maryland City Plaza, Inc.*, 371 F.Supp. 1154, 1158 (D.C. Md. 1974).

First, Itel agreed in Section 6.3 of the lease to accept the premises "in their condition existing as of the date of the execution hereof . . . ," and "acknowledge[d] that neither Lessor nor Lessor's agents ha[d] made any representation or warranty as to the suitability of the Premises for the conduct of Lessee's business." Itel also agreed under Section 8.7 that Chapman:

> shall not be liable for injury to Lessee's business or any loss of income therefrom or for damages to the goods, wares, merchandise or other property of Lessee . . . whether the said damage or injury results from conditions arising upon the Premises or upon other portions of the building of which the Premises are a part. . . .

If Itel had wished to make Chapman liable under a turn-key contract, it would not have prepared and executed an instrument expressly relieving Chapman of liability to Itel and expressly disclaiming warranty as to the suitability of the premises to Itel's business. As the court in *Glassman* pointed out:

> Ordinarily the industry understanding of the term [turn-key] would be controlling. . . . However, in the instant contract the term was expressly defined as requiring compliance with the tenant's lease requirements and bearing all costs, therefore controlling over the industry usage.

371 F.Supp. at 1158 (citations omitted).

In *Hawaiian Independent Refinery, supra,* a case similar in its fact to the case before us, the court chose to look past the label "turn-key" to conclude that the owner's active participation in the "makeup of the contract plans and specifications" and the disclaimer of liability on the part of the contractor demonstrated that the parties' agreement was not a turn-key contract. 697 F.2d at 1067-68. Itel, while not the owner of the property, participated in both the described relevant activities.[7]

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7. Itel tries to distinguish *Hawaiian Independent Refinery* on the basis that Itel did not own the property. The reasons for holding the owner liable in *Hawaiian Independent Refinery,* however, are applicable to Itel. Itel clearly had the upper hand in bargaining, had the right to purchase the property at the end of the lease, and initiated and conducted the arrangements between the parties.

[4] Choosing not to apply the common industry meaning of "turn-key," the district court found the contract a lease agreement without deeming any of the contract provisions inconsistent. The court held that Chapman presented Itel with a facility that conformed to the specifications that both parties had agreed could handle Itel's normal business operations. It was correct, therefore, for the court to find that the destruction of the property resulted from Itel's misrepresentations of what constituted "normal business operations" coupled with the misuse by Itel of the property. In sum, Itel breached the contract.

We agree with the application of the law of contract by the district court. But the result is the same even if "turn-key" in the common usage had been the general intent of the parties. Contracting parties retain the right to "allocat[e] the risks among themselves as they see fit" in the "turn-key" situation. *See Martin v. Vector Co.*, 498 F.2d 16, 25 (1st Cir. 1974); *see also, Mobile Housing Environments v. Barton & Barton*, 432 F.Supp. 1343 (D.C. Colo. 1977). As the Court in *Mobile Housing Environments* concluded, "the term 'turn-key construction job' . . . imposes upon the contractor the responsibility for providing the design of the project and responsibility for any deficiencies or defects in design, *except to the extent that such responsibility is specifically waived or limited by the contract documents.*" 432 F.Supp. at 1346 (emphasis added). Here the other provisions in the lease relieve Chapman of any possible liability regardless of the meaning of "turn-key" in the contract.

C. *Liability of Itel Under Contract Law*

[5] Itel argues that the district court misperceived the relationship between Chapman and Itel even if the court

correctly found the contract not to be the usual turn-key construction contract. Itel claims that as the general contractor, Chapman was responsible for design deficiencies. *See Emerald Forest Utility Dist. v. Simonsen Constr. Co.*, 679 S.W.2d 51, 52-53 (Tex. App.—Houston [14th Dist.] 1984, writ ref'd n.r.e.). While the general rule might hold general contractors liable, it is inapplicable to the facts in this case. *See United States v. Spearin*, 248 U.S. 132, 137, 39 S. Ct. 59, 61, 63 L.Ed. 166 (1918). *See also Newell v. Mosley*, 469 S.W.2d 481, 483 (Tex. Civ. App.—Tyler 1971, writ ref'd n.r.e.). The Supreme Court in *Spearin* states:

> . . . if the contractor is bound to build according to plans and specifications prepared by the owner, the contractor will not be responsible for the consequences of defects in the plans and specifications. This responsibility of the owner is not overcome by the usual clauses requiring builders to visit the site, to check the plans, and to inform themselves of the requirements of the work, as is shown by *Christie v. United States*, 237 U.S. 234, 35 Sup. Ct. 565, 59 L.Ed. 933; . . . where it was held that the contractor should be relieved, if he was misled by erroneous statements in the specifications.

Id. (some citations omitted). Chapman carried out the construction according to the plans prepared by Itel and mutually approved. Chapman cannot be held responsible for defects in those plans.[8]

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8. Itel also argues that Chapman breached the implied warranty of suitability that was recently recognized by the Texas Supreme Court in *Davidow v. Inwood North Professional Group Phase I*, 747 S.W.2d 373, 377 (1988). The warranty requires "at the inception of the lease [for] there [to be] no latent defects in the facilities that are vital to the use of the premises for their intended commercial purpose and that these essential facilities will remain in a suitable

Chapman did not breach the contract. Rather, Itel breached it by failing to pay rent, by failing to make repairs as it had contracted to do, and by vacating the premises. The district court correctly awarded damages to Chapman for Itel's breach of the contract.

III. ALLEGED IMPROPER RELIANCE BY THE DISTRICT COURT ON EXTRAJUDICIAL KNOWLEDGE OF THE UNDERLYING FACTS

[6] Itel claims the trial court relied upon personal knowledge of matters outside the trial record, which allegedly circumvented the administration of justice.

While it is clear the judge made several comments throughout the trial which implied knowledge of the construction industry, Itel fails to show any improper reliance on that knowledge by the trial judge or any prejudice to its case by any possible improper reliance. *Price Bros. Co. v. Philadephia Gear Corp.*, 649 F.2d 416, 420 (6th Cir.), *cert. denied*, 454 U.S. 1099, 102 S. Ct. 674, 70 L.Ed.2d 641 (1981). This Court discussed the role of a trial court judge in the handling of a protracted bench trial in *Ruiz v. Estelle*, 679 F.2d 1115, 1129 (5th Cir. 1982), *cert. denied*, 460 U.S. 1042, 103 S. Ct. 1438, 75 L.Ed.2d 795 (1983). We said:

> Though the trial judge must be neutral, he should not be a passive spectator . . . He may, when in his sound discretion he deems it advisable, comment

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condition." *Id.* What Itel fails to point out is in the very next sentence of the opinion, the Texas Supreme Court recognizes that "the parties to a lease [may] expressly agree that the tenant will repair certain defects, [and] then the provisions of the lease will control." *Id.* Itel expressly agreed to be responsible for repairs and for any defects in the premises.

> on the evidence, question witnesses, elicit facts not yet adduced or clarify those previously presented, . . .

Itel fails to show where the district judge moved beyond his proper role or how Itel was prejudiced. As the finder of fact, a judge must rely upon his or her experience and common sense. No more was involved here.

IV. THE IMPOSITION OF SANCTIONS AGAINST ITEL

A. *Rule 11 Sanctions*

[7] The correct standard for reviewing a courts' imposition of sanctions under Fed. R. Civ. P. 11 on both questions of fact and questions of law is abuse of discretion. *Thomas v. Capital Secur. Services, Inc.*, 836 F.2d 866, 872 (5th Cir. 1988) (en banc). Rule 11 sanctions were imposed against Itel for asserting its RICO counterclaim.[9] The trial judge found the counterclaim without merit and part of a defensive strategy designed to make the cost of litigation so high that Chapman would be forced to abandon the fight.[10]

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9. Rule 11 provides that the signature of an attorney is a certificate that the signer had read the pleadings, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after a reasonable inquiry it is well grounded in fact and warranted by existing law . . . and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. Fed. R. Civ. P. 11.

10. The district court also held Itel violated Rule 11 by failing properly to review and reevaluate its position as the case developed. Prior to *Thomas*, this Court did impose a continuing duty on attorneys to review and reevaluate their position as their case continued. In *Thomas*, we determined that there are other rules to handle a developing duty such as Rule 26(g) for abuse of discovery, and reevaluation is not necessary under Rule 11. 836 F.2d at 874; *See Robinson v. National Cash Register Co.*, 808 F.2d 1119, 1127

Itel clearly had ample opportunity to present its position. Itel received notice as early as ten months before trial that sanctions might be imposed when Chapman filed a motion to impose sanctions. Itel also was repeatedly warned throughout the trial of the possibility of sanctions. After trial, Itel was again warned when both Chapman and Ehrentraut renewed their motions for imposition of sanctions. Finally, after a show cause hearing where Itel was allowed to put on evidence, the judge decided to award sanctions.

This Court en banc recently discussed an attorney's obligations under Rule 11. *Thomas,* 836 F.2d at 873-76. In *Thomas* we held that compliance with Rule 11 requires, when signing a pleading, motion, or other document,

> 1) that the attorney has conducted a reasonable inquiry into the facts which support the document;
>
> 2) that the attorney has conducted a reasonable inquiry into the law such that the document embodies existing legal principles or a good faith argument 'for the extension, modification, or reversal of existing law;' and
>
> 3) that the motion is not interposed for purposes of delay, harassment, or increasing costs of litigation.

Id. at 873-74. Also, an attorney's subjective "good faith" does not protect him from Rule 11 sanctions. *Robinson,* 808 F.2d at 1127.

(5th Cir. 1987). The district court erred then in holding Itel to this continuing duty although it properly relied on the *Robinson* holding since *Thomas* had not yet been decided. We, however, can uphold the sanctions as awarded since the district court awarded them under Rule 26 and 37 as well as Rule 11.

The district court found that the RICO action was based at best upon the subjective belief of Itel's attorney without enough concrete evidence to bring the cause of action, and at worst, on the improper purposes of causing delay and increasing expenses to Chapman. The district court thus had as a basis for sanctions either the first or the third affirmative duty set out in *Thomas*.

Itel undertook to support its RICO claim that Ehrentraut received "kickbacks" to "turn his head" during the construction of the flexible surface by initially proffering: 1) copies of five cancelled checks from Novotny and Dantex Erectors to Ehrentraut; 2) statements made by John Montgomery during a taped telephone conversation with Hassell; 3) the fact that Ehrentraut occasionally did work for Novotny as an independent contractor and was a partner in a company with Novotny; 4) the fact that Chapman confronted Ehrentraut about his involvement with Novotny; and 5) the fact that if either Novotny or Ehrentraut admitted to this scheme, they would subject themselves to possible criminal charges.

The district court found the only possible "solid" evidence at the time of the initial filing was the taped conversation between Montgomery and Hassell and the five cancelled checks. The court correctly concluded that neither amounted to proper grounds for bringing a RICO cause of action. The court heard the tape *in camera* after it was brought to the court's attention at the show cause hearing. The court ruled that it contained only rumors.[11] As to the checks, during the trial and the show

11. The judge found Montgomery had no personal knowledge of the truth of the allegations. Hassell herself admitted that she did not ask Montgomery about the names, dates, places, or circumstances underlying the rumors that he had heard. Hassell thus failed

cause hearing, Urquhart & Hassell was unable to point to any evidence that linked the check payments to Ehrentraut with the work performed by Treat. Rather, the evidence clearly proved that the five checks issued to Ehrentraut were for legitimate business activities that did not relate to this particular project.[12] It follows that Itel's counsel filed the complaint based on unverified hearsay—not a sufficient basis upon which to "subject one to the burdens of complex litigation and heavy legal costs." *See Miller v. Schweickart,* 413 F.Supp. 1059, 1061 (S.D.N.Y. 1976). A RICO cause of action by definition involves complex litigation and high legal costs.

Itel and its counsel now try to argue that they were precluded at trial from discussing the RICO issue since the suit against Ehrentraut was never tried; thus, they argue they were never given the opportunity to prove their claim. They were given numerous opportunities to do so during cross-examination, however, and they had fair warning that sanctions might be imposed if additional evidence in support of their claim was not forthcoming. At a pretrial conference, the trial court warned Itel of the weakness of the RICO claim. Itel responded that there was plenty of evidence, but when the court asked Itel to produce that evidence within 60 days, none was provided. Itel also failed at the show cause hearing to supply any additional information on the objective reasonableness of its pleading.

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to explore readily available avenues of inquiry and on that basis alone could be sanctioned for filing a factually frivolous appeal. *See Calloway v. Marvel Entertainment Group,* 111 F.R.D. 637, 646-47 (S.D.N.Y. 1986).

12. Urquhart & Hassell again failed to follow reasonable avenues of exploration. Had it bothered to investigate before filing the suit, it would have learned Ehrentraut legitimately worked for Novotny as an independent contractor "after hours" for legitimate pay.

Finally, it should be noted that an attorney's responsibility to conduct a reasonable prefiling investigation is particularly important in RICO claims:

> Given the resulting proliferation of civil RICO claims and the potential for frivolous suits in search of treble damages, greater responsibility will be placed on the bar to inquire into the factual and legal bases of potential claims or defenses prior to bringing such suit or risk sanctions for failing to do so.

Black & Magenheim, *Using the RICO Act in Civil Cases,* 22 Hous. Law 20, 24-25 (Oct. 1984). *See also Fahrenz v. Meadow Farm Partnership,* 850 F.2d 207 (4th Cir. 1988).

B. *Rules 26 and 37 Sanctions*

The district court found that in connection with the RICO claim, Itel's attorneys also abused the discovery process. The district court stated its awareness of the superior resources of Itel. It then found evidence of an attempt to innudate Chapman with unnecessary discovery requests to raise the cost of the litigation to a point that Chapman would be forced to "give up without a fight" because of the expense. 665 F.Supp. at 1284. In particular, the court found that the discovery conducted by Itel's attorneys "was unreasonable, unnecessary, and unduly burdensome" in violation of Rule 26(g).[13] The

13. Rule 26(g) provides in pertinent part:
Every request for discovery or response or objection thereto made by a party represented by an attorney shall be signed by at least one attorney. . . . The signature of the attorney or party constitutes a certification that he has read the request, response, or objection, and that to the best of his knowledge, information, and belief formed after a reasonable inquiry it is:

court also found that, in violation of Rule 37(a)(3), Itel improperly failed to disclose the existence of the taped telephone conversation between Hassell and Montgomery in Itel's response to an interrogatory.[14]

[8] Under 26(g), Urquhart & Hassell was under a duty similar to the duty under Rule 11 to make a reasonable inquiry into the basis of the action:

> The duty to make a 'reasonable inquiry' is satisfied if the investigation undertaken by the attorney and the conclusions drawn therefrom are reasonable under the circumstances. It is an objective standard similar to the one imposed by Rule 11 . . . Ultimately what is reasonable is a matter for the court to decide on the totality of the circumstances.

Fed. R. Civ. P. 26(g) Advisory Committee is note (1983). The record clearly reflects extensive discovery by Itel. Urquhart & Hassell deposed Lestor Schalit, Ehrentraut, Brent Warren, J.E. Lewis, and John Montgomery. In addition, it deposed Treat on three different occasions and Chapman twice. The court found the discovery burdensome in light of the continued lack of any additional evidence. This finding did not abuse the judge's discretion.

> . . . 2) not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; and 3) not unreasonable or unduly burdensome or expensive, given the needs of the case, the discovery already had in the case, the amount in controversy, and the importance of the issues at stake in the litigation. . . .

Fed. R. Civ. P. 26(g).

14. The district court found numerous other violations as well. The judge found other internal reports of Itel that were improperly withheld, evidence of attempted intimidation of witnesses, and requests for documents that were also unduly burdensome on non-party witnesses.

[9] The failure to inform opposing counsel of the tape also warranted sanction. The failure amounted to an incomplete response to an interrogatory question.[15] An incomplete response is sanctionable and is considered to be evasive under Rule 37.[16] *See Dollar v. Long Mfg., N.C., Inc.*, 561 F.2d 613, 616-17 (5th Cir. 1977), *cert. denied*, 435 U.S. 996, 98 S. Ct. 1648, 56 L.Ed.2d 85 (1978).

[10] Itel and its counsel claim that they were not under a duty to reveal the tape since it constitutes work product. For two reasons this contention cannot prevail. First, the clandestine taping of a telephone conversation implicitly waives the protection of the work product doctrine because it violates the American Bar Association's Model Rules of Professional Conduct. *See Parrott v. Wilson*, 707 F.2d 1262, 1270-72 (11th Cir.), *cert. denied*, 464 U.S. 936, 104 S. Ct. 344, 78 L.Ed.2d 311 (1983). Second, Itel should have filed a work product

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15. The question asked in the Chapman's fifth set of interrogatories was worded as follows:

Interrogatory No. 4:

Please state with specificity and particularity all of the documents, records, memoranda, written indicia and/or any other evidence, whether or not written which indicate or support the allegation that Mr. Norman Ehrentraut 'knowingly solicited and accepted benefits and payments from subcontractors involved in constructing the Itel facility on the agreement or understanding that the benefits and payments would influence the conduct of third party defendant in relation to the affairs of his employer.

Itel's answer was:

Answer:

Copies of cancelled checks evidencing payments from E.J. Novotny and Dantex Erectors are attached hereto.

16. Additionally, the failure to disclose the existence of the tape was actionable under 26(g) because it prolonged needlessly the litigation of this claim.

objection within 30 days of receipt of the interrogatory to preserve the objection. Fed. R. Civ. P. 33. Its failure to do so amounted to a waiver. Thus, the trial court also correctly sanctioned Itel and its counsel under Rule 37.

C. *The Amount Awarded*

[11] The district court imposed sanctions in the amount of $20,000 on Itel and its attorneys under Rules 11, 26, and 37 without specifying the sum actually awarded under each rule. Itel and Urquhart & Hassell each were ordered to pay $10,000 of the $20,000. Ehrentraut was to receive $5,000 and Chapman was to receive the remaining $15,000. We find no abuse by the district court in the amount assessed.

First, the district court correctly determined an "appropriate" sanction under Rule 11. Once a violation was found, the judge was mandated to impose sanctions. The choice of sanction was, however, within the trial court's broad discretion. *Thomas,* 836 F.2d at 876. In *Thomas,* we listed possible types of sanctions, noting the purpose of sanctioning:

> [w]hether sanctions are viewed as a form of cost-shifting, compensating opposing parties injured by the vexatious or frivolous litigation forbidden by Rule 11, or as a form of punishment imposed on those who violate the rule, *the imposition of sanctions pursuant to Rule 11 is meant to deter attorneys from violating the rule.*

Id. at 877 (quoting *Donaldson v. Clark,* 819 F.2d 1551, 1556 (11th Cir. 1987) (en banc) (emphasis added).

Here the trial judge chose a monetary sanction as appropriate.[17]

Itel and its counsel argue that even if monetary sanctions are appropriate under Rule 11, the amount should be reduced by the amount awarded under Rule 37. Under that Rule they can only be held responsible for the reasonable expenses caused by their failure to comply with discovery. *See Batson v. Neal Spelce Associates, Inc.*, 765 F.2d 511 (5th Cir. 1985). They assert that assess-

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17. The district court did not make specific findings as to the imposition of the Rule 11 sanctions. Such findings, however, are not required in all cases. As we said in Thomas,

> If the sanctions imposed are substantial in amount, type, or effect, appellate review of such awards will be inherently more rigorous; such sanctions must be quantifiable with some precision. Therefore, justification for the Rule 11 decision in the record must correspond to the amount, type, and effect of the sanction applied. . . . We therefore reject a rule that would impose upon district courts the onerous and often time-consuming burden of making specific findings and conclusions in all Rule 11 cases. In doing so, it should be clearly understood that when the basis and justification for a Rule 11 decision is not readily discernible on the record, an adequate explanation by the trial court for the decision will be necessary.

Thomas, 836 F.2d at 883. The record in this case reflects clearly the reasons behind the imposition of sanctions so that no specific findings as to amount awarded were required.

Also, as the Fourth Circuit stated in *Fahrenz*

> it is important to note that Rule 11 speaks in terms of an 'appropriate sanction.' What constitutes reasonable expenses within the context of Rule 11 must be considered in relation with the Rule's goals of deterrence, punishment, and compensation. In this respect, "reasonable" does not necessarily mean actual expenses and attorney's fees. Instead Rule 11 leaves the determination of the "appropriate sanction" to the sound discretion of the trial court. . . .

850 F.2d at 211. While *Fahrentz* addresses the specific situation of expenses as a sanction, the same reasoning applies where the court imposes sanctions that are not tied to expenses. Here, the sanction imposed is reasonable in light of the expenses involved in the litigation.

ment of fees is limited only to those flowing from the specific abuses of the discovery process. *See Stillman v. Edmund Scientific Co.*, 522 F.2d 798 (4th Cir. 1975). This claim is fruitless, however, because we find the total amount awarded appropriate under Rule 11 without a finding under any other rule.

Even if Rule 11 did not cover the full amount awarded, it is clear the total amount of sanctions was also appropriate under the discovery rules. The district court clearly found Itel and its counsel to have continued unreasonably for several years the massive discovery requests after finding no additional evidence to support Itel's claim. Not one witness was produced with personal knowledge of any kickbacks. The district court cannot be said to have abused its discretion in the award of sanctions or the amount awarded.

V. CLAIM FOR FUTURE RENT

[12] The district court properly denied Chapman's claim for future rent for the unexpired term of the Itel lease, the period covering May 1, 1987, through January 31, 1991. The district court held that Chapman failed to offset against the value of the alleged future unpaid rent either the fair market value of the unexpired term of the lease or the amount of payments to be received by Chapman from subsequent tenants. Chapman's failure precluded under Texas law recovery of any amount for future rent. The court reached this decision by finding that Chapman chose to treat Itel's abandonment as an anticipatory breach under common law. This finding was not clearly erroneous.[18]

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18. The district court found alternatively: 1) If Chapman intended to reduce the amount of future rent by subsequent tenants'

With the conclusion that Chapman treated the default as an anticipatory breach, the issue becomes the measure of damages. Chapman admitted at trial the applicability of *Crabtree v. Southmark Commercial Management,* 704 S.W.2d 478, 480 (Tex. App.—Houston [14th Dist.] 1986, writ ref'd n.r.e.), to the facts of the case. 665 F.Supp. at 1293. This assertion led both Itel and the court to conclude that Chapman was seeking common law damages under section 13(c) of the lease. *Crabtree* sets out the common law measure of damages available to a landlord for anticipatory breach. The plaintiff must prove the present value of future rents less the present value of actual rents received or the cash market value of the property for the remainder of the lease. *Id.* Chapman now attempts to assert *Crabtree* is inapplicable.

In its petition, Chapman sued for "loss of rents." At trial, Chapman relied solely on the testimony of Howard Chapman to establish the amount of lost future rent. Chapman initially calculated these future damages based on the total amount due under the lease from July 1, 1981, to January 31, 1991. From that amount, Chapman subtracted the actual rents that had been received from subsequent tenants and discounted that sum to its present

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rent, which was its contention in its Reply to Defendant's Response to Plaintiff's Motion for Final Judgment, there would be no recovery since the amount realized on subsequent leases exceeded the amount due under the Itel lease. On the other hand, (2) if the court treated Chapman as not realizing anything on the additional leases, Chapman's damages for future losses would be the present value of the unexpired term less the fair market value of the term. Again, Chapman recovers nothing because it failed to put on any expert evidence to support its claim. Under either approach, the district court held Chapman failed to meet the burden of proving the amount of damages for future losses on the unexpired term of the lease. 665 F.Supp. at 1294-95 (citing to *Johnson v. Lane,* 524 S.W.2d 361, 365 (Tex. Civ. App.—Dallas 1975, no writ)).

value. During cross-examination, Chapman admitted that the figure as calculated did not take into account the reasonable cash market value of the unexpired lease or the rental amounts to be received by subsequent tenants.[19]

Chapman argues that it was electing recovery of damages under Section 13(a) of the contract and not Section 13(c) as the trial court held. Chapman argues that it was entitled to do that under Section 16.11 of the contract. It asserts that while Section 13(c) "incorporated" the common law for breach by the tenant, Section 13(a) displaced and superseded the ordinary common law measures of damages. Under Section 13(a), the contract language suggests that the burden of proof on the future cash market value of the property was on Itel. Thus, Chapman argues that it did not have to reduce future rent by any amount and that it was up to Itel to produce reduction evidence. The district court, however, correctly held that under *Crabtree*, the burden of proof was on Chapman to prove the amount of future losses.

Further, even if Chapman were right in its assertion, Chapman still cannot prevail. Itel correctly relied on the unrefuted valuation of the unexpired term as derived

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19. The district court laid out the fact scenario:
. . . the facts are clear that Chapman and Cole initially chose to treat Itel's conduct as an anticipatory breach of contract, repossess the property and lease it to a new tenant, Container Maintenance Service, Inc. . . . Under the terms of the industrial lease with CMS, CMS was to pay Chapman and Cole rent at the reduced rate of $6,000 per month while repairs were being made to the container yard. Once the repairs were completed, CMS would then pay the agreed upon monthly rental of $16,500 for the duration of the ten-year lease. In addition, under the terms of the triple-net-lease, CMS was also responsible for the payment of taxes and insurance. . . . The facts indicate, however, that this did not occur. 665 F.Supp. at 1293. Itel was obligated to pay $11,101.67 under its lease, an amount far below the subsequent lease.

from the admitted evidence of the CMS lease and subsequent leases on the property[20] for proof that the future cash market value of the property exceeded the amount due under the remainder of the lease, allowing no recovery for future rents even under Section 13(a) of the lease.[21] *See Cameron v. Calhoun-Smith Distributing Co.*, 442 S.W.2d 815, 817 (Tex. Civ. App.—Austin 1969, no writ) (a tenant is entitled to a credit for all the rent a subsequent tenant agrees to pay for the period the subsequent tenant occupies the premises after a tenant's abandonment, regardless of whether those payments are collected or uncollected). It follows that even if Itel had the burden of proof, Itel carried that burden. Thus, we conclude that the decision of the district court on the damages awarded was without error.

VI. THE APPROPRIATE POST-JUDGMENT INTEREST RATE

[13] Chapman argues that when jurisdiction is based on diversity of citizenship, the rate applied post-judgment should be determined by the applicable state law, which would be Texas law in this case. Under Texas law, the appropriate rate would be the contract rate of 10% per annum. Tex. Rev. Civ. Stat. Ann. art. 5069-1.05, § 1(1)

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20. CMS terminated the lease after going into bankruptcy. After retaking possession, Chapman relet it again. It appears this tenant is still on the property, but that the tenant still has not made any rent payments. 665 F.Supp. at 1293.

21. Section 16.11 of the contract makes the remedies under the contract cumulative. The trial court, however, had reason for holding Chapman to an election since in its April 29, 1987 motion, Chapman specifically argued it was entitled to recover "the contractual rental reduced by the amount to be received from the new tenants, as set forth in *Crabtree* . . . , 665 F.Supp. at 1294-95," suggesting its choice to use common law damages.

(Vernon 1985). We must reject this contention, however, and uphold the district court's application of 28 U.S.C. § 1961 as amended.[22] Amended § 1961 "replaced the directive for applying the state rate of interest with a nationwide variable rate of interest based upon a formula using the rate paid by the Government for 52-week treasury bills." *Brooks v. United States*, 757 F.2d 734, 740 (5th Cir. 1985). Under amended § 1961, the correct interest rate applicable in this case is 7% per annum.[23]

Chapman's argument that Texas law should still govern since this is a diversity case is based upon cases decided before § 1961 was amended and on *Erie R.R. Co. v. Tompkins*, 304 U.S. 64, 78-79, 58 S. Ct. 817, 822-23, 82 L.Ed. 1188 (1938). *See Degelos Bros. Grain Corp. v. Fireman's Fund Ins. Co.*, 498 F.2d 1238, 1239 (5th Cir. 1974) ("In a diversity case state law governs the award of interest, 28 U.S.C. § 1961 notwithstanding"); *Southland Life Ins. Co. v. Stone*, 112 S.W.2d 336, 337 (Tex. Civ. App.—Dallas 1938, no writ). In *Erie*, the Supreme Court declared that federal courts exercising jurisdiction in diversity of citizenship cases should apply state law except in "matters governed by the Federal Constitution or by Acts of Congress." 304 U.S. at 78-79, 58 S. Ct. at 822-23.

Since the statutory amendment, however, the great majority of the circuit courts have held that the amended

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22. Prior to October 1, 1982, § 1961 provided generally for post-judgment interest "calculated from the date of the entry of the judgment, at the rate allowed by state law." It was amended in the Federal Courts Improvement Act of 1982, Pub. L. 97-164, § 302(a), 96 Stat. 25, 55-56 (codified at 28 U.S.C. § 1961(a) (Supp. 1983)).

23. This Court had expressly reserved this issue since the enactment of amended § 1961 until today. *See Bartholomew v. C.N.G. Producing Co.*, 832 F.2d 326, 330 n. 3 (5th Cir. 1987).

§ 1961 applies in diversity cases as well as other federal cases. They have specifically held that § 1961 applies to "any judgment in a civil case recovered in a district court, . . . *including actions based on diversity of citizenship.*" *Weitz Co. v. Mo-Kan Carpet, Inc.*, 723 F.2d 1382, 1385-86 (8th Cir. 1983) (emphasis added). *See also, G.M. Brod & Co. v. U.S. Home Corp.*, 759 F.2d 1526, 1542 (11th Cir. 1985); *Roy Stone Transfer Corp. v. Budd Co.*, 796 F.2d 720, 723 n. 6 (4th Cir. 1986); *Elias v. Ford Motor Co.*, 734 F.2d 463, 467 n. 6 (1st Cir. 1984); *Drovers Bank of Chicago v. National Bank & Trust Co.*, 829 F.2d 20, 23 n. 3 (8th Cir. 1987); *Bailey v. Chattem, Inc.*, 838 F.2d 149, 151-53 (6th Cir.), *cert. denied*, ____U.S.____, 108 S. Ct. 2831, 100 L.Ed.2d 931 (1988); *International Telemeter, Corp., v. Hamlin International Corp.*, 754 F.2d 1492, 1494 (9th Cir. 1985); *Lowell Staats Mining Co. v. Pioneer Uravan, Inc.*, 645 F.Supp. 254, 258-59 (D. Colo. 1986); *Harmon v. Clark Equipment Co.*, 657 F.Supp. 873 (D. Me. 1987); *Commonwealth Edison Co. v. Decker Coal Co.*, 653 F.Supp. 841, 845 (N.D. Ill. 1987). *But see Davis & Cox v. Summa Corp.*, 751 F.2d 1507, 1522 (9th Cir. 1985); *Weitz Co.*, 723 F.2d at 1387-88 (dissenting opinion took the position that if Congress had intended to change the law for post-judgment interest, it would have done so more explicitly). The statute has been amended and is clear. We hold in agreement with virtually all the circuit courts that have considered the issue. Section 1961 applies to all civil cases in federal courts. No reason is found, including the terms of the statute, to find it not applicable to cases where federal jurisdiction is based upon diversity of citizenship.

VII. CONCLUSION

We affirm the district court's judgment in full. The district court correctly decided that the contract was not a "turn-key" construction contract but rather a commercial lease. The court correctly assessed damages against Itel for breach of that contract when it vacated the premises, failed to make proper repairs, and failed to pay rent.

As to the sanctions awarded, the court correctly imposed sanctions under Fed. R. Civ. P. Rule 11 and also under the discovery rules, Fed. R. Civ. P. Rules 26 and 37. The amount imposed was reasonable and fell within the court's discretion.

As to the request for sanctions for this appeal under Fed. R. App. P. Rule 38, we are not persuaded that the imposition of sanctions is warranted. Therefore, we deny the appellees' motion for further sanctions under this rule.

Finally, the court correctly denied future rent as part of the damage award and properly awarded post-judgment interest by calculating it in accordance with the amended 28 U.S.C. § 1961.

AFFIRMED.

APPENDIX B

CHAPMAN & COLE, et al.,
Plaintiff,

v.

ITEL CONTAINER INTERNATIONAL B.V., et al.,
Defendant,

v.

Norman EHRENTRAUT,
Third-Party Defendant.

Civ. A. No. H-83-5945.

United States District Court,
S.D. Texas,
Houston Division.

July 22, 1987.

Third-party defendant in contract dispute sought sanctions against defendant's attorneys for failure to make objectively reasonable inquiry into merits of third-party claim, and for abuse of discovery. The District Court, Singleton, Chief Judge, held that: (1) defendant's attorneys failed to make reasonable inquiry into merits of third-party RICO claim, and failed to dismiss claim after engaging in extensive discovery, warranting imposition of sanctions, and (2) attorneys' abuse of discovery also warranted sanctions.

Ordered accordingly.

See also 665 F.Supp. 1283.

J. Douglas Sutter, Ross, Griggs & Harrison, Houston, Tex., for plaintiff.

Edward D. Urquhart, Urquhart & Hassell, Houston, Tex., for defendant.

MEMORANDUM AND ORDER

SINGLETON, Chief Judge.

INTRODUCTION

The matters currently before this Court are the plaintiffs' and third-party defendant's Motions for Sanctions against Itel Container International (hereinafter "Itel"), and its attorneys, Urquhart & Hassel. This action was tried before this Court during a bench trial that began on April 6, 1987 and lasted seven-days. At the conclusion of the trial, this Court indicated from the bench that sanctions would not be imposed. However, prodded by plaintiff's motion to reconsider, this Court subsequently reviewed the tapes from two pre-trial conferences in this action, as well as the recent Fifth Circuit case law addressing the imposition of sanctions, and determined that a show cause hearing should be conducted to determine whether sanctions should be imposed. Notice was sent to the parties and a hearing was held on May 5, 1987. Having now considered the arguments and testimony presented at the May 5, 1987 Show Cause Hearing, along with all memoranda filed in support of each sides respective positions, this Court makes the following findings from the facts presented in this action.

DISCUSSION

1. *Preliminary Matters*

As a preliminary matter, this Court must address defendant's contention that third-party defendant, Norman Ehrentraut's post-trial request for sanctions violates the terms of the approved settlement agreement. Defendant's attorneys contend that as part of an approved settlement with Mr. Ehrentraut, Itel agreed to dismiss its third-party complaint in return for which Mr. Ehrentraut agreed to withdraw his motion for sanctions. Mr. Ehrentraut argues, however, that the agreement only applied with reference to his motion against Itel and does not apply to his request for sanctions against Itel's attorney's, Urquhart & Hassell.

To support its contention that Mr. Ehrentraut's request for sanctions amounts to a breach of the approved settlement agreement, Itel's attorneys draw reference to two letters sent by Mr. Ehrentraut's attorney, Fritz Barnett. The letters clearly indicate that Mr. Ehrentraut agreed to drop his motion for sanctions as part of the settlement agreement. Mr. Barnett's post-trial assertion that Mr. Ehrentraut's agreement was only intended to apply with reference to his motion against Itel, and not with reference to his motion against Itel's attorneys, seems slightly contrived. If Mr. Barnett intended to dismiss only a portion of Mr. Ehrentraut's motion for sanctions as part of the agreement, then his correspondence with Itel's attorneys was certainly misleading. In addition, if Itel's attorneys had known that this was Mr. Barnett's intention then it is unlikely that they would have agreed to settle with Mr. Ehrentraut.

Notwithstanding the terms of the settlement agreement with Mr. Ehrentraut, however, this Court has the authority, if not the duty, to impose Rule 11 sanctions against any attorney who fails to make an objectively reasonable inquiry into the merits of a claim. *See Southern Leasing Partners, Ltd. v. McMullan,* 801 F.2d 783 (5th Cir. 1986). In its Note to Rule 11, the Advisory Committee on rules states succinctly the purpose behind the Rule:

> [t]he word "sanctions" in the caption . . . stresses a deterent orientation in dealing with improper pleadings, motions or other papers. . . . And the words "shall impose" in the last sentence focus the Court's attention on the need to impose sanctions for pleading and motion abuses. The court, however, retains the necessary flexibility to deal appropriately with violations of the rule. It has discretion to tailor sanctions to the particular facts of the case, with which it should be well acquainted.

As the Fifth Circuit has noted, Rule 11 "is simple and poses no threat to competent lawyers. Simply put, a lawyer must have a basis for his pleadings." *Southern Leasing,* 801 F.2d at 789. The law is abundantly clear: where an attorney does not have an objectively reasonable basis for filing or continuing to urge a pleading before the Court, the Court must impose some type of Rule 11 sanctions. *Robinson v. National Cash Register Co.,* 808 F.2d 1119, 1126 n. 12 (5th Cir. 1987).

[1] In addition to the authority granted the Court by the rule itself, the defendant's attorneys are also aware that this Court retained jurisdiction during two pretrial conferences to impose sanctions if the allegations against

Mr. Ehrentraut proved to be baseless. In fact, this Court's exact words during those conferences were that sanctions "would be imposed" if these allegations proved to be false. While this Court must accept the terms of the settlement agreement as it applies to Mr. Ehrentraut's motion against Itel, this Court will not extend that agreement to protect Itel's attorneys. In fact, this Court finds that the "twelfth-hour" settlement with Mr. Ehrentraut on the eve of the trial was nothing more than a ploy used by Itel's attorneys in an effort to avoid sanctions. The justifications given by Urquhart and Hassell for their client's last minute settlement with Mr. Ehrentraut are unpersuasive and require very little discussion.

Basically, the law firm alleges that it supported Itel's decision to settle because it feared that this Court would grant a continuance which would have had the "potential adverse effects" of unavailability of key Itel witnesses and increased costs of litigation to Itel. *See* Affidavit of Pascal Paul Piazza, May 10, 1987. In addition, the firm questioned whether Itel would be able to collect any judgment it might obtain against Mr. Ehrentraut. *Id.*

The argument that a continuance, which defendant's attorneys had no way of knowing would even be considered by this Court, would have had such a devastating impact on witness availability in a case filed over three years ago is totally unpersuasive. In addition, this Court is knowledgable enough to know that the additional expense that a continuance might have caused would have been trivial when compared to the total costs of this litigation to Itel. Finally, there is nothing to support the claim that Itel's attorneys learned anything in March of 1987 about the status of Mr. Ehrentraut's financial situation that they were not aware of previously. Simply

stated, the reasons given by Urquhart & Hassell for the last minute settlement with Mr. Ehrentraut are nothing more than feeble attempts to justify their position. This Court, however, rejects all of the justifications offered by the law firm and finds instead that the real justification for the settlement with Mr. Ehrentraut was to avoid possible sanctions.

This Court wishes to address one additional prefatory argument raised by Itel in its Memorandum of Law Supporting the Denial of Sanctions. Itel's attorneys argue that sanctions should not be imposed because "[t]his Court has recognized the plausibility of Itel's case by denying all previous motions to dismiss, previous motions for summary judgment, and previous motions for sanctions." *See* Memorandum of Law Supporting the Denial of Sanctions Against Itel Container International B.V. and Itel Container International Corporation and Their Attorneys, May 11, 1987, at 3. This argument is unpersuasive because, as noted earlier, defendant's attorneys were present at the two pretrial conferences when this Court deferred ruling on the issue of sanctions until after the trial. This Court has difficulty understanding how defendant's attorneys could have misconstrued this Court's actions as a show of support for their position. Additionally, defendants' attorneys should be aware that the Fifth Circuit has previously rejected this argument in upholding a district court's award of sanctions. In *Barrios v. Pelham Marine, Inc.*, 796 F.2d 128, 132 (5th Cir. 1986), the Court noted:

> Pelham's position on appeal is that its cross-complaint could not have been frivilous or else the district court would have granted Texaco's motion for summary judgment instead of proceeding to trial.

> Pelham should have been content with only a $750 penalty. . . . The district court's decision to carry over a motion to trial when the trial preparation has been completed and the trial is ready to begin is hardly sufficient to infuse a vapid claim with life. . . . We also vacate the district court's award of $750 for sanctions in accordance with Rule 11 so that it might, on remand, consider the possibility of imposing more severe sanctions.

Id. at 132-33.

2. *The Standard For Imposing Rule 11 Sanctions*

The Fifth Circuit recently discussed in-depth the standard to be used when assessing a lawyer's conduct for potential Rule 11 violations. In *Robinson v. National Cash Register Co.*, 808 F.2d 1119 (5th Cir. 1987), the Court noted that the revised version of Rule 11 was expanded to place a greater duty on attorneys and to reduce the reluctance of Courts to impose sanctions. *Robinson,* 808 F.2d at 1127. Quoting from the Advisory Committee's Note to the revised version of Rule 11, the Court points out that "the standard of whether an attorney has made a sufficient inquiry into the facts and law is one of reasonableness under the circumstances, the revised Rule 11 standard is more stringent than the original good-faith formula and thus . . . a greater range of circumstances will trigger its violation." *Robinson,* 808 F.2d at 1127. Thus, the Court has held that the revised rule imposes an "objective, rather than subjective, standard of reasonableness," and, in the words of the Court, "[a]n attorney's good faith is no longer enough to protect him from Rule 11 sanction." *Id.*

The affirmative duty placed on an attorney by Rule 11 to conduct a "reasonable inquiry" into both the factual

and legal basis of any document before signing it, does not end with the filing of the pleading, motion, or other document in court. *Robinson,* 808 F.2d at 1127. The Fifth Circuit has noted that "the inquiry required by Rule 11 is not a one time only obligation." *Id.* Counsel has a continuing obligation to review and reevaluate his position as the case develops. *Id.; see also, Southern Leasing,* 801 F.2d at 788. Thus, the Court has concluded:

> [a] document that intially satisfies the requirements of Rule 11 may later turn out to be the basis for Rule 11 sanctions as new facts are discovered which show that there is no longer a good faith basis for the document. Upon discovering that a good faith basis no longer exists, it is incumbent upon the appropriate counsel and party to take necessary actions to ensure that the proceedings do not continue without a reasonable basis in law and fact.

Robinson, 808 F.2d at 1127.

3. *Findings Regarding the Imposition of Sanctions*

A. *The RICO claims*

The May 11, 1987 Show Cause Hearing was held to provide the defendants and their attorneys an opportunity to address the issues set forth in this Court's May 5, 1987 notice of setting. Essentially, this Court ordered the defendants and their attorneys to address three matters of concern to this Court: (1) whether defendants' attorneys had made a sufficient inquiry into the facts before filing the Rico and Texas Deceptive Trade Practices Act Claims; (2) whether defendants' attorneys failed to withdraw these claims after discovering that there was no longer an objectively reasonable basis for pursuing them;

and (3) whether Itel authorized its agent, Allen P. Goldade, to sign a false and misleading affidavit.

Regarding the first two matters, Sylvia Hassell, a partner with the law firm of Urquhart & Hassell, testified during the Show Cause Hearing as to the facts which she considered provided a reasonable basis for filing the Rico cause of action against Mr. Ehrentraut and the Texas Deceptive Trade Practices Act claims against the plaintiffs. The facts are also set forth in an affidavit submitted by Ms. Hassell.

In their Rico claim against Mr. Ehrentraut, defendants' alleged that Mr. Ehrentraut took kickbacks from E.J. Novotny, owner of DanTex Erectors. The defendants' charged that as a result of receiving these kickbacks Mr. Ehrentraut improperly supervised the construction of the Itel facility, specifically, the work done by subcontractors Novotny and Treat.

The initial facts which Ms. Hassell claims supported the decision to bring the Rico Act claims can be summarized rather easily: (1) copies of five cancelled checks from E.J. Novotny and DanTex Erectors made payable to Norman Ehrentraut; (2) statements made by John Montgomery during a taped telephone conversation with Ms. Hassell on June 9, 1983; (3) the defendants' expert's testimony that the construction on the Itel site was substandard; (4) the fact that Mr. Ehrentraut occasionally did work for Mr. Novotny as an independent contractor and was a partner in a company with Mr. Novotny known as DanTex General Contractors; (5) the fact that Mr. Ehrentraut was confronted by Mr. Chapman when he learned about the outside work Mr. Ehrentraut had done for Mr. Novotny; (6) the fact that DanTex

Erectors was replaced on the Itel site as building contractor because of their failure to meet construction deadlines; (7) Itel's knowledge that if either Mr. Ehrentraut or Mr. Novotny "admitted to the payment or receipt of such kickbacks they would be admitting to commercial bribery, . . . ;" and (8) the fact that Mr. Ehrentraut supervised some of the work performed on the Itel site. *See Affidavit of Silvia T. Hassell,* filed May 11, 1987, at 6-18.

Two separate inquiries must be made in determining whether Ms. Hassell violated her Rule 11 duty. The first is whether Ms. Hassell made a sufficient inquiry into the facts before filing the Rico claims. Then, assuming she made a sufficient initial inquiry, the second question is whether she failed to reevaluate the reasonableness of going forward with the Rico claims given the facts later discovered. *See Robinson, supra.*

It is difficult for a Court to evaluate the sufficiency of an attorney's inquiry prior to filing a claim. Such an evaluation requires the Court to delve into the attorney's initial thought processes. For this reason, it would be unfair to use hindsight as the sole gauge in making such an evaluation. Therefore, in this case the Court must evaluate Ms. Hassell's actions in light of the Fifth Circuit's adopted standard: Was Ms. Hassell's decision to bring the Rico claims objectively reasonable given the circumstances? *See Robinson, supra.*

Since Rule 11 is not a rule of strict liability, a Court can presumably consider both the circumstances surrounding the filing of the pleading as well as the facts available to the attorney at the time of filing. In this action, however, Ms. Hassell raises no issue concerning

the circumstances surrounding the filing of the Rico claims. Therefore, this Court must evaluate Ms. Hassell's decision to file the claim based solely on the facts available to her at the time of filing.

The relevant facts available to Ms. Hassell at the time of filing can be reduced to two; (1) her telephone conversation with Mr. Montgomery, and (2) the discovery of the five checks written by DanTex Erectors and made payable to Mr. Ehrentraut. In evaluating these facts as the basis for filing the Rico claims, this Court must consider whether Ms. Hassell's investigation into these facts was sufficient to warrant the filing of such counterclaims. Stated differently, the question raised is whether Ms. Hassell's initial inquiry into these facts was that which a reasonably prudent attorney would have objectively made in light of the severity of these allegations.

This Court finds that Ms. Hassell's initial inquiry into the facts surrounding the alleged Rico claims was not objectively reasonable under the circumstances. To begin with, this Court has made an *in camera* review of the transcript and tape of the telephone conversation between Ms. Hassell and Mr. Montgomery. The transcript indicates that during the conversation Mr. Montgomery made it clear that his knowledge of the facts were based on nothing more than sheer speculation. Mr. Montgomery indicated that he had no first-hand knowledge of any kickbacks, and, moreover, he states unequivocally that none of the stories he heard about Mr. Ehrentraut ever involved the Itel project. Simply stated, Ms. Hassell should have been aware that Mr. Montgomery's statements had little, if any, substantive value.

The only solid evidence then of any illegal payments were the five checks from DanTex Erectors. To evaluate

the sufficiency of Ms. Hassell's inquiry into these facts one need look no further than the trial transcript. The clear and convincing evidence in this case was that Mr. Ehrentraut legitimately worked for Mr. Novotny as an independent contractor on other Chapman & Cole job sites for the legitimate payments evidenced by these five checks. Therefore, the clear and convincing evidence was that these payments did not involve the Itel facility in any manner. Additionally, Mr. Novotny was not involved with the construction of the flexible surface on the Itel site. Mr. Treat was the only individual who did any work on the flexible surface. During both the trial and the show cause hearing, Ms. Hassell was unable to point to any evidence that would link the payments made to Mr. Ehrentraut to the work performed by Mr. Treat on the yard's surface. Since there never was any evidence or inferences of any "kickbacks", bribes or other illegal payments associated with the Itel project, this Court must conclude that Ms. Hassell's initial inquiry was either insufficient or that Ms. Hassell was aware that no evidence existed but chose to ignore it. In either case, her decision to bring the Rico claims based on the initial inquiry performed was not objectively reasonable and, therefore, violated Rule 11. *See Robinson, supra.*

However deserving of sanctions Ms. Hassell's decision to bring the Rico claims may have been, her decision to maintain those claims after engaging in further discovery is even more so deserving under the circumstances. Notwithstanding the fact that the evidence indicated that the payments made to Mr. Ehrentraut were for legitimate work, Ms. Hassell and Mr. Urquhart engaged in extensive discovery. Urquhart & Hassell took numerous depositions of all the relevant participants in the alleged conspiracy.

Urquhart & Hassell deposed Lester Schalit, Norman Ehrentraut, E.J. Novotny, Brent Warren, J.E. Lewis and John Montgomery. In addition, they deposed Mr. Treat on three separate occasions and Mr. Chapman twice. Although each witness deposed informed Urquhart & Hassell that he had no knowledge of any wrong doing regarding Mr. Ehrentraut or the Itel project, Urquhart & Hassell persevered in their attempt to prove that illegal activity had occurred on the Itel site. In a further attempt to acquire evidence to support the Rico claims, Mr. Schalit testified during the trial that Urquhart & Hassell attempted to intimidate him with threats of lawsuits against him and further accused him of receiving "kick-backs." When given the opportunity to contest these accusations in open court, Urquhart & Hassell chose not to cross-examine Mr. Schalit.

Regarding the reasonableness of Ms. Hassell's decision to rely on the statements made by Mr. Montgomery during the taped conversation, Mr. Montgomery testified that following the conversation Ms. Hassell sent him an affidavit which she had prepared for his signature. Mr. Montgomery testified that upon receiving the affidavit he "tore it in four pieces and threw it in the waste basket," because in his words "about the only thing really accurate was my name and address and profession." This Court has compared the statements contained in the affidavit with the transcript from the telephone conversation. None of the statements contained in the affidavit prepared by Ms. Hassell, regarding Mr. Montgomery's first-hand knowledge of what transpired at the Itel construction site, could ever have been inferred from any of the statements made during the phone conversation.

Therefore, this Court finds that it was entirely unreasonable for Ms. Hassell to maintain the Rico claims in light of what she learned through her extensive discovery. Furthermore, this Court finds that none of the four "new" facts that Ms. Hassell claims to have discovered after the August 4, 1986 pretrial conference in any way advanced the merits of the Rico claims. *See Affidavit of Silvia T. Hassell,* at 24-25. Thus, it is clear to this Court that Ms. Hassell's decision to maintain the Rico claims was based upon her subjective belief that Mr. Ehrentraut had taken kickbacks. This conclusion is supported by a statement made by Ms. Hassell in her own sworn affidavit:

> 4. The following are the facts that provided the basis for my statement to the Court on August 18, 1986 that defendants had "plenty of evidence" to support their RICO claims:
>
> * * * *
>
> (e) *My personal belief in the truth* of the statements made by John Montgomery on June 9, 1983, that in his opinion the Itel facility failed because of the actions of Norman Ehrentraut;

Affidavit of Silvia T. Hassell, at 6-8 (emphasis added). As noted earlier, the Fifth Circuit has specifically held that an attorney must evaluate the facts using an objective, rather than subjective, standard of reasonableness. *Robinson,* 808 F.2d at 1127. Urquhart & Hassell's decision to go forward with the Rico claims up until the week before the trial was not an objectively reasonable decision in light of facts uncovered during discovery.

[2] Therefore, this Court finds that Ms. Hassell's decision not to dismiss the counterclaim against Mr.

Ehrentraut constituted a clear violation of Rule 11. Her failure to make an objective evaluation of the facts caused Mr. Ehrentraut to suffer unnecessarily the financial and emotional strains of being a litigant in this action. Additionally, her decision further complicated this matter for Chapman & Cole, prolonging the outcome and forcing Chapman & Cole to absorb additional, unnecessary litigation costs. For this reason, both Mr. Ehrentraut and Chapman & Cole should receive some degree of indemnification for Ms. Hassell's imprudent actions. Therefore, since this Court finds that the conduct of the signing attorney, Ms. Hassell, was improper and unreasonable under Rule 11, the Court is required to fashion an appropriate sanction.[1] *Fed. R. Civ. P. 11; Robinson,* 808 F.2d at 1130 ("By employing the word "shall" the drafters intended to stress the mandatory imposition of sanctions when the requirements of Rule 11 have been violated.")

B. *Discovery Abuses*

In connection with the above Rule 11 violations, this Court also finds that Urquhart & Hassell abused the discovery process in violation of Rule 26(g). Rule 26(g) provides in pertinent part:

> Every request for discovery or response or objection thereto made by a party represented by an attorney shall be signed by at least one attorney of record in his individual name, whose address shall be stated.

1. This Court has considered the evidence relied upon by Ms. Hassell in bringing the Texas Deceptive Trade Practices Act claims and finds, given the broad scope of the statute, that Ms. Hassell's actions in bringing those claims does not warrant an imposition of sanctions.

> . . . The signature of the attorney or party constitutes a certification that he has read the request, response, or objection, and that to the best of his knowledge, information, and belief formed after a reasonable inquiry it is: . . . (2) not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; and (3) not unreasonable or unduly burdensome or expensive, given the needs of the case, the discovery already had in the case, the amount in controversy, and the importance of the issues at stake in the litigation. . . .

Fed. R. Civ. P. 26(g). In its note to subsection (g), the Advisory Committee on rules points out that Rule 26(g) imposes an affirmative duty on attorneys "to engage in pretrial discovery in a responsible manner." Additionally, the note continues: "Rule 26(g) is designed to curb discovery abuse by explicitly encouraging the imposition of sanctions." *See ACF Industries, Inc. v. EEOC,* 439 U.S. 1081, 99 S. Ct. 865, 59 L.Ed.2d 52 (1979). As the Advisory Committee's note indicates, the test to be used when evaluating whether the attorney conducted a "reasonable inquiry" is an objective one similar to that imposed under Rule 11:

> The duty to make a "reasonable inquiry" is satisfied if the investigation undertaken by the attorney and the conclusions drawn therefrom are reasonable under the circumstances. It is an objective standard similar to the one imposed by Rule 11. . . . Ultimately what is reasonable is a matter for the court to decide on the totality of the circumstances.

Fed. R. Civ. P. 26(g), Advisory Committee on Rules, note to subdivision (g).

[3] This Court finds that much of the discovery conducted by Urquhart & Hassell in connection with the alleged Rico claims was unreasonable, unnecessary, and unduly burdensome given the facts known by the attorneys early on in this action. *See Fed. R. Civ. P. 26(g).* As noted in the previous section of this Memorandum and Order, the clear and convincing evidence throughout this case indicated that the payments made to Mr. Ehrentraut were for legitimate work performed by him for Dan-Tex Erectors. Notwithstanding the weight of the evidence, Urquhart & Hassell continued to conduct extensive discovery in the hope of finding some evidence of illegal activity. After numerous depositions failed to produce even a shred of evidence of illegal activity, Urquhart & Hassell re-took the depositions of Mr. Treat and Mr. Chapman. Still, without a single shred of evidence to support their claims, Urquhart & Hassell requested permission to take Mr. Treat's deposition for a third time to inquire into his bank records. Contrary to this Court's express order, a review of the deposition transcript indicates that Urquhart & Hassell used this opportunity to go over questions previously asked of Mr. Treat.

In addition to the numerous depositions, Urquhart & Hassell required non-party witnesses to produce voluminous amounts of unnecessary documents. The facts indicate that one such witness, Mr. Brent Warren, a partner of Mr. Ehrentraut in business activities unrelated to the Itel project, was required to produce volumes of bank records and checks pursuant to Itel's discovery request. No evidence of kickbacks or other illegitimate activity was ever produced from Mr. Warren's records.

As noted earlier, the facts also indicate that Urquhart & Hassel abused the discovery process by attempting to

intimidate at least one nonparty witness in an effort to elicit testimony to support the Rico claims. Mr. Lester Schalit testified in open court that Urquhart & Hassell threatened him with potential lawsuits and accused him of taking kickbacks. During the Show Cause Hearing, Ms. Hassell and Mr. Urquhart denied these allegations. However, the trial transcript clearly shows that when given the opportunity, Urquhart & Hassell chose not to cross-examine Mr. Schalit regarding these very damaging allegations. In addition, the transcript of Mr. Schalit's deposition indicates that Mr. Urquhart told Mr. Schalit that he had been informed that Mr. Schalit had taken kickbacks. When asked by Mr. Barnett who his source of that information was Mr. Urquhart replied that Mr. Barnett would find out during the trial. *See* First Amended Motion for Sanctions of the Plaintiffs, filed January 20, 1985, at 8-9. The trial and Show Cause Hearing have now been completed and as yet no credible source for Mr. Urquhart's allegation has ever been produced.

As this Court noted in the "Findings of Fact and Conclusions of Law" entered in this action, the manner in which Urquhart & Hassell conducted its discovery in this case caused unnecessary delays, unduly burdened witnesses and needlessly increased the costs of this litigation. The attorneys' actions were not objectively reasonable under the circumstances and, therefore, merit sanctions pursuant to Rule 26(g), Fed. R. Civ. P.

C. *Plaintiffs' Fifth Set of Interrogatories to Defendant*

[4] The final issue that this Court raised in the May 5, 1987 Notice of Hearing, involved Plaintiffs' Fifth Set of Interrogatories. Initially, this Court ordered the defendant, Itel Container Corp., to show cause why this

Court should not impose sanctions for authorizing its agent, Mr. Allen P. Goldade, to sign answers to interrogatories which he testified at trial he did not know were true at the time he signed them. The defendants' argued in response that it was required to have an agent sign the interrogatories on behalf of the corporation even if the agent lacked personal knowledge of information contained in the answers. This Court finds this to be an accurate statement of the law.

Fed. R. Civ. P. 33(a) provides that where interrogatories are directed at a corporation, the corporation must designate someone to answer on its behalf with "such information as is available to the party." *United States v. Kordel,* 397 U.S. 1, 90 S. Ct. 763, 25 L.Ed.2d 1 (1970). With reference to interrogatories propounded upon a corporation, the phrase "such information as is available to the party" has been construed to mean all information available to the corporation's officers, directors, employees and attorneys. *See General Dynamics Corp. v. Selb Mfrs. Co.,* 481 F.2d 1204, 1210-11 (8th Cir. 1973). Therefore, the agent signing the answers to interrogatories on behalf of the corporation cannot limit his answers to only information within his personal knowledge. *Id.*

In the present action, Mr. Goldade signed the answers to Plaintiff's Fifth Set of Interrogatories as "authorized agent for defendant Itel Container International B.V." *See* Defendants' Answers to Plaintiff's Fifth Set of Interrogatories. Therefore, it was not necessary that Mr. Goldade have personal knowledge of all the information contained within the corporation's answers. In fact, the corporation was obligated pursuant to Fed. R. Civ. P.

33(a) to provide all information available to Itel's officers, directors, employees, and attorneys. As such, Mr. Goldade's act of signing the answers to the interrogatories as an agent of Itel, without personal knowledge of all the information contained therein, does not merit the imposition of sanctions.

[5] What clearly does merit sanctions, however, is defendants' incomplete answer to Interrogatory No. 4 contained in Plaintiff's Fifth Set of Interrogatories. As previously stated, Fed. R. Civ. P. 33(a) mandates that a corporation answering interrogatories furnish *all information* available to its officers, directors, employees and attorneys. *See General Dynamics,* 481 F.2d at 1210. It is clear, that Itel's answer to Interrogatory No. 4 was incomplete and therefore must be treated as a failure to respond. *See* Fed. R. Civ. P. 37(a)(3); *Dollar v. Long Mfg., N.C., Inc.,* 561 F.2d 613, 616 (5th Cir. 1977).

The question asked by plaintiffs' Interrogatory No. 4 is clear and specific:

> INTERROGATORY NO. 4:
>
> Please state with specificity and particularity all of the documents, records, memoranda, written indicia and/or any other evidence, whether or not written which indicate or support the allegation that Mr. Norman Ehrentraut "knowingly solicited and accepted benefits and payments from subcontractors involved in constructing the Itel facility on the agreement or understanding that the benefits and payments would influence the conduct of third party defendant in relation to the affairs of his employer."

Itel's answer to Interrogatory No. 4 was equally clear and specific:

ANSWER:

Copies of cancelled checks evidencing payments from E.J. Novotny and DanTex Erectors are attached hereto.

The problem with Itel's answer is that it failed to disclose material information known to the corporation's in-house and trial counsel; namely, the existence of the tape recorded telephone conversation between Ms. Hassell and Mr. Montgomery.

Itel argues that its answer to Interrogatory No. 4 was not incomplete for two reasons. First, Itel argues that "the plain text" of plaintiff's interrogatory was directed only to the identification and production of evidence. *See* The Reply of Itel to Plaintiffs' Reply to Defendants' Response on Rule 11 Motion and Statement of Position, Fact and Law pertaining to this Court's Hearing of May 11, 1987, at 17. Specifically, Itel argues that the phrase "and/or any other evidence" was intended to limit the scope of plaintiffs' inquiry to include only items that would be admitted into evidence by the defendants. As such, Itel claims that the interrogatory "did not address the tape or the tape transcript [because] by definition both are not evidence." *Id.* at 17. Itel's interpretation of the text of Interrogatory No. 4 is not objectively reasonable. Reading the interrogatory as a whole, it is clear that plaintiffs did not intend for Itel to identify and produce only those documents which Itel intended to offer into evidence at trial. It should have been clear to Itel that the phrase "and/or other evidence" was added to broaden the scope of plaintiffs' request, not limit it. Therefore, Itel's first explanation for its failure to include within its answer the telephone conversation with Mr. Montgomery is wholly inadequate.

The second explanation offered for Itel's failure to include the conversation with Mr. Montgomery in its response to Interrogatory No. 4 is equally unpersuasive. In support of their decision not to disclose the existence of the tape or transcript, Itel and its attorneys argue that "the immunity protecting both the tape and the transcript eliminates by operation of law the need to identify or disclose either the tape or the tape transcript." *See* The Reply of Itel to Plaintiff's Reply to Defendants' Response on Rule 11 Motion and Statement of Position, Fact and Law Pertaining To The Court's Hearing of May 11, 1987, at 17-18. Essentially, the argument made on Itel's behalf by its attorneys is that the tape and tape transcript contained the mental impressions of Ms. Hassell which are protected under the work product doctrine contained in Fed. R. Civ. P. 26(b)(3).

The problem with Itel's response is that it assumes too much and goes beyond what is actually protected under Rule 26(b)(3). To begin with, Itel's response assumes that this Court would have agreed with the attorney's assessment of the contents of the tape and transcript. Having now completed an *in camera* review of the tape and transcript, this Court finds that only a very small portion of the transcript contains Ms. Hassell's mental impressions, conclusions, opinions or legal theories concerning this litigation. As the Notes of the Advisory Committee on Rules indicates, a Court may find it necessary to order disclosure of a document that contains relevant facts but with portions of the document deleted to protect the attorneys mental impressions and opinions. *See* Fed. R. Civ. P. 26, Notes of the Advisor Committee on Rules. This court have been done rather easily in this case with the tape transcript. In any event, this was a

decision that should have been made by this Court after Itel identified the existence of the tape in Plaintiff's Interrogatory No. 4. It was certainly not a decision that Itel's attorneys should have made on their own. As one Court has stated, "[i]n the final analysis, it is the Court's duty and not the duty of the one asserting the privilege to determine whether a communication is, in fact, priviledged." *See International Tel. & Tel. Corp. v. United Tel. Co. of Florida,* 60 F.R.D. 177, 185 (M.D. Fla. 1973).

Therefore, this Court finds that Itel's response to Plaintiff's Interrogatory No. 4 was incomplete. Rule 33 requires that an interrogatory be fully answered by the party or that objection to it and the grounds of objection be stated. Fed. R. Civ. P. 33. As the Fifth Circuit has noted:

> Discovery by interrogatory requires candor in responding. . . . The candor required is a candid statement of the information sought or of the fact that objection is made to furnishing the information. *A partial Answer by a party reserving an undisclosed objection to answering fully is not candid. It is evasive.*

Dollar v. Long Mfg., N.C., Inc., 561 F.2d 613, 616-17 (5th Cir. 1977). The Rule 33 requirement that a party disclose its objections to an interrogatory applies to all privileges, including the work-product qualified immunity from discovery. *See Dollar,* 561 F.2d 613; *Compagnie Francaise D'Assurance v. Phillips Petroleum,* 105 F.R.D. 16 (S.D.N.Y. 1984); *In re Shopping Carts Antitrust Litigation,* 95 F.R.D. 299 (S.D.N.Y. 1982); *International*

Telephone and Telegraph Corp. v. United Telephone Co. of Florida, 60 F.R.D. 177 (M.D. Fla. 1973).

Since Itel provided only a partial response to Interrogatory No. 4 without disclosing the work-product objection, its answer must be treated as an incomplete and evasive answer. *See Dollar*, 561 F.2d 613. Rule 37(a)(3) makes clear that "an evasive or incomplete answer is to be treated as a failure to answer." Fed. R. Civ. P. 37 (a)(3). Pursuant to Rule 37, this Court has the power to impose sanctions upon the defendants and their counsel for their incomplete and evasive answer to Interrogatory No. 4. *See Moody v. Schwartz*, 97 F.R.D. 741 (S.D. Tex. 1983). In addition, this Court also has the power to impose sanctions, pursuant to Rule 26(g), against the defendants and their counsel for failing to disclose the existence of the telephone conversation with Mr. Montgomery. Given the fact that the defendants' incomplete and evasive response needlessly prolonged the litigation of defendants' meritless Rico claim, this Court finds that sanctions should be imposed.

CONCLUSION

This Court finds that given the severity of the above stated actions, sanctions should be imposed pursuant to Rules 11, 26 and 37, Fed. R. Civ. P.

Accordingly, it is ORDERED, ADJUDGED, and DECREED that Plaintiff's Motion for Sanctions is hereby GRANTED, and that pursuant to this Order sanctions in the amount of $20,000 are hereby imposed against the defendants' and its attorneys, Urquhart and Hassell, to be paid in the following manner: $10,000 to be paid

by the defendants; Itel Container International B.V., *et al.;* and $10,000 to be paid by the defendants' attorneys, Urquhart and Hassell. It is further ORDERED that payment of the $20,000 be made in the following manner; $5,000 to third-party defendant, Norman Ehrentraut, as attorneys fees; and $15,000 to plaintiffs; Chapman and Cole, *et al.,* for costs and attorneys fees associated with this matter.

Payment of the above amounts shall be made on or before September 1, 1987, in the manner prescribed by this Order. The defendants and their counsel shall supply this Court with copies of the cancelled checks as proof of payment.

APPENDIX C

STATUTORY PROVISIONS

Rule 11. Signing of Pleadings, Motions, and Other Papers: Sanctions

Every pleading, motion, and other paper of a party represented by an attorney shall be signed by at least one attorney of record in the attorney's individual name, whose address shall be stated. A party who is not represented by an attorney shall sign the party's pleading, motion, or other paper and state the party's address. Except when otherwise specifically provided by rule or statute, pleadings need not be verified or accompanied by affidavit. The rule in equity that the averments of an answer under oath must be overcome by the testimony of two witnesses or of one witness sustained by corroborating circumstances is abolished. The signature of an attorney or party constitutes a certificate by the signer that the signer has read the pleading, motion, or other paper; that to the best of the signer's knowledge, information, and belief formed after reasonable inquiry it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. If a pleading, motion, or other paper is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the pleader or movant. If a pleading, motion, or other paper is signed in violation of this rule, the court, upon motion or upon its own initiative, shall impose upon the person who signed it, a represented

party, or both, an appropriate sanction, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, motion, or other paper, including a reasonable attorney's fee.

The relevant portion of Federal Rule of Civil Procedure 26 is 26(g) as set forth below:

(g) Signing of Discovery Requests, Responses, and Objections. Every request for discovery or response or objection thereto made by a party represented by an attorney shall be signed by at least one attorney of record in the attorney's individual name, whose address shall be stated. A party who is not represented by an attorney shall sign the request, response, or objection and state the party's address. The signature of the attorney or party constitutes a certification that the signer has read the request, response, or objection, and that to the best of the signer's knowledge, information, and belief formed after a reasonable inquiry it is (1) consistent with these rules and warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law; (2) not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; and (3) not unreasonable or unduly burdensome or expensive, given the needs of the case, the discovery already had in the case, the amount in controversy, and the importance of the issues at stake in the litigation. If a request, response, or objection is not signed, it shall be stricken unless it is signed promptly after the omission is called to the attention of the party making the request, response, or objec-

tion, and a party shall not be obligated to take any action with respect to it until it is signed.

If a certification is made in violation of the rule, the court, upon motion or upon its own initiative, shall impose upon the person who made the certification, the party on whose behalf the request, response, or objection is made, or both, an appropriate sanction, which may include an order to pay the amount of the reasonable expenses incurred because of the violation, including a reasonable attorney's fee.

The relevant portions of Federal Rule of Civil Procedure 37 are 37(a)(3) and (d) as set forth below:

(3) Evasive or incomplete answer. For purposes of this subdivision an evasive or incomplete answer is to be treated as a failure to answer.

(d) Failure of Party to Attend at Own Deposition or Serve Answers to Interrogatories or Respond to Request for Inspection. If a party or an officer, director, or managing agent of a party or a person designated under Rule 30(b)(6) or 31(a) to testify on behalf of a party fails (1) to appear before the officer who is to take the deposition, after being served with a proper notice, or (2) to serve answers or objections to interrogatories submitted under Rule 33, after proper service of the interrogatories, or (3) to serve a written response to a request for inspection submitted under Rule 34, after proper service of the request, the court in which the action is pending on motion may make such orders in regard to the failure as are just, and among others it may take any action authorized under paragraphs (A), (B), and (C) of subdivision (b)(2) of this rule. In lieu of any order or in addition thereto, the court shall require the party fail-

ing to act or the attorney advising that party or both to pay the reasonable expenses, including attorney's fees, caused by the failure, unless the court finds that the failure was substantially justified or that other circumstances make an award of expenses unjust.

The failure to act described in this subdivision may not be excused on the ground that the discovery sought is objectionable unless the party failing to act has applied for a protective order as provided by Rule 26(c).

The relevant portions of 18 U.S.C. § 1961 are § 1961 (1)(A), (3), (4) and (5) as set forth below:

§ 1961. Definitions

As used in this chapter—

(1) "racketeering activity" means (A) any act or threat involving murder, kidnaping, gambling, arson, robbery, bribery, extortion, or dealing in narcotics or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year;

(3) "person" includes any individual or entity capable of holding a legal or beneficial interest in property;

(4) "enterprise" includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;

(5) "pattern of racketeering activity" requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and

the last of which occurred within ten years (excluding any period of imprisonment) after the commission of a prior act of racketeering activity;

The relevant portion of 18 U.S.C. § 1962 is § 1962 (c) as set forth below:

§ 1962. Prohibited activities

(c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

The relevant portion of 18 U.S.C. § 1964 is § 1964 (c) as set forth below:

§ 1964. Civil remedies

(c) Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee.

The relevant portion of 18 U.S.C. § 1965 is § 1965(a) as set forth below:

§ 1965. Venue and process

(a) Any civil action or proceeding under this chapter against any person may be instituted in the

district court of the United States for any district in which such person resides, is found, has an agent, or transacts his affairs.

The version of Texas Penal Code § 32.43(b) applicable to activities occurring prior to September 1, 1983, is set forth below:

§ 32.43. Commercial Bribery

(a) For purposes of this section:

(1) "Beneficiary" means a person for whom a fiduciary is acting.

(2) "Fiduciary" means:

(A) an agent or employee;

(B) a trustee, guardian, custodian, administrator, executor, conservator, receiver, or similar fiduciary;

(C) a lawyer, physician, accountant, appraiser, or other professional advisor; or

(D) an officer, director, partner, manager, or other participant in the direction of the affairs of a corporation or association.

(b) A person who is a fiduciary commits the offense of commercial bribery if he intentionally or knowingly solicits, accepts, or agrees to accept any benefit as consideration for (1) violating a duty to a beneficiary, or (2) otherwise causing harm to a beneficiary by act or omission.